TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

No. 263.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

JOHN G. WHITE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

PETITION FOR CERTIORARI FILED MARCH 26, 1923.
CERTIORARI AND RETURN FILED JULY 5, 1923.

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1 [Caption omitted in printing.]

2 UNITED STATES OF AMERICA,
Northern District of Ohio, Eastern Division, ss.:

In the District Court of the United States, for the Northen District of Ohio, Eastern Division.

No. 10430.

JOHN G. WHITE, PLAINTIFF,

against

HARRY H. WEISS, COLLECTOR OF UNITED STATES INTERNAL REVENUE for the Eighteenth District of the State of Ohio, defendant.

Amended Petition for Money only.

Filed April 24, 1920.

The plaintiff, John G. White, by White, Johnson, Cannon and Spieth, his attorneys, complains of the defendant, Harry H. Weiss, Collector of United States Internal Revenue for the Eighteenth District of the State of Ohio, for that—

At all the times hereinafter mentioned, plaintiff was and now is a citizen of the State of Ohio, and a resident of the Eighteenth Internal Revenue District of the State of Ohio.

At all the times hereinafter mentioned, the defendant was, and now is, the collector of United States internal revenue for the Eighteenth District of the State of Ohio.

The National Acme Manufacturing Company was, during the year 1916, a corporation organized and existing under and by virtue of the laws of the State of Ohio.

On the 15th day of March, A. D. 1916, said corporation had outstanding capital stock in the amount of four million dollars ($4,000,000.00), divided into one million five hundred thousand dollars ($1,500,000.00) of preferred stock and two million five hundred thousand dollars ($2,500,000.00) common stock, each share being of the nominal or par value of one hundred dollars ($100.00) each. At said date the book value of the assets of said company, excluding liabilities other than capital stock and surplus, amounted to
3 more than six million six hundred and ninety thousand dollars ($6,690,000.00), the excess of said assets over the par value of its capital stock representing profits of the corporation which had been earned prior to that date and invested by the company in its business.

On the 15th day of March, A. D. 1916, a stock dividend of 100 per cent was declared by said corporation, payable to common stockholders of record on March 21, A. D. 1916. In accordance with

said declaration the officers of said The National Acme Manufacturing Company transferred from its surplus account to capital stock account the sum of two million five hundred thousand dollars ($2,500,000.00), and issued to the common stockholders of record of the said company on March 21, 1916, additional shares of stock in the proportion of one share of new common stock for each share of old common stock held by each common stockholder on that date. On that date plaintiff was the owner and holder of certificates of the common capital stock of said The National Acme Manufacturing Company, in the amount of thirty-three thousand dollars ($33,000.00) par value, and there was issued to him, in accordance with said resolution, additional shares of common stock in said company to the amount of the nominal or par value of thirty-three thousand dollars ($33,000.00). Because of the increase in the number of parts in which the ownership of the assets of the corporation, as represented by its common capital stock, was divided, the asset or book value of each share of common stock representing an equal aliquot part in the total assets of said company was proportionately decreased; the number of shares owned by each stockholder was increased by one hundred per cent (100%), and, at the same time the book value of each common share was correspondingly decreased, that is to say, that for the month prior to the closing of the books of said readjustment of the capital, on the 21st day of March, 1916, the book value of each share of the company's common stock was twice that of each share of the common stock after said one hundred per cent (100%) dividend had been declared, so that the book value of the common capital stock owned by each stockholder, including therein this plaintiff, was substantially unchanged, by reason of the said stock dividend and receipt of said certificates for said additional shares of common stock. In other words, the same interest or ownership by plaintiff in the property of said corporation was evidenced after said stock dividend by certificates for twice as many shares as before.

4 On the 8th day of November, A. D. 1916, the National Acme Manufacturing Company's said preferred stock had been called in and arrangements made for its liquidation, and its issued common stock was five million dollars ($5,000,000.00); its assets, excluding good will and patents, were at least ten million dollars ($10,000,000.00). Thus, the tangible assets made the stock worth at least two hundred dollars ($200.00) a share. On that day the officials and stockholders of said The National Acme Manufacturing Company made an agreement with Eastman, Dillon & Company, a copy of which is attached hereto, marked "Exhibit A" and made a part hereof, by which the officers and stockholders of The National Acme Manufacturing Company and said Eastman, Dillon & Company agreed to organize a new corporation under the laws of the State of Ohio, named The National Acme Company, having an authorized capital stock of twenty-five million dollars ($25,000,000.00) divided into five hundred thousand (500,000) shares of the par value of fifty

dollars ($50.00) a share, to take over all the assets and liabilities of the National Acme Manufacturing Company; that said Eastman, Dillon & Company were to pay the stockholders of the National Acme Manufacturing Company seven million five hundred thousand dollars ($7,500,000.00) in cash for half of their stock, and the new company was to issue to the old stockholders of the National Acme Manufacturing Company two hundred and fifty thousand (250,000) shares of the National Acme Company stock of the par value of fifty dollars ($50.00) a share for their stock, and to said Eastman, Dillon & Company two hundred and fifty thousand (250,000) shares of the same par value for their stock. The certificates of stock of the National Acme Company were not to be delivered to the stockholders of the National Acme Manufacturing Company until the 1st day of May, A. D. 1917. This agreement was carried out. All of the stockholders of the National Acme Manufacturing Company deposited their stock under said agreement at the time limited in said agreement. The National Acme Company was incorporated, the money was paid, and its stock issued and delivered in accordance with said agreement. On the same basis on which the stock of the National Acme Manufacturing Company was worth two hundred dollars ($200.00) a share, the book value of the stock of the National Acme Company was only twenty dollars ($20.00) per share, or forty dollars ($40.00) per one hundred dollars ($100.00) par value, but whatever the value of the stock, the National Acme Company had exactly the same property, neither more nor less than had the National Acme Manufacturing Company, and whatever the value of the assets as they were now represented by twenty-five million dollars ($25,000,000.00) of stock of the National Acme Company the same assets had theretofore been represented by five million dollars ($5,000,000.00) of stock of the National Acme Manufacturing Company, and stock of the nominal or par value of one hundred dollars ($100.00) of the National Acme Company represented ownership of only two-fifths (2/5) of the same assets represented by the corresponding nominal or par value of the stock of the National Acme Manufacturing Company. Thus, what the stockholders of the National Acme Manufacturing Company actually got was seven million five hundred thousand dollars ($7,500,000.00) in cash, and stock of the National Acme Company representing ownership of exactly the same assets as their previous stock in the National Acme Manufacturing Company.

Applying these facts to the plaintiff's case, on the 21st of March, A. D. 1916, plaintiff was the owner of certificates of the par value of thirty-three thousand five hundred dollars ($33,500.00) of stock in the National Acme Manufacturing Company, and the addition of an one hundred per cent (100%) stock dividend gave plaintiff certificates for sixty-seven thousand dollars ($67,000.00) par value of stock. For this sixty-seven thousand dollars ($67,000.00) plaintiff received one hundred thousand five hundred dollars ($100,500.00) cash from Eastman, Dillon and Company, and from the National

Acme Company certificates for one hundred and sixty-seven thousand five hundred dollars ($167,500.00) of the par value of the stock of the National Acme Company, evidencing his ownership of one hundred and sixty-seven thousand five hundred twenty-five millionths ($\frac{167,500}{25,000,000}$) of exactly the same property of which he had theretofore owned sixty-seven thousand five-millionths ($\frac{67,000}{5,000,000}$). No new property or funds went into the new company. The twenty-five million dollars ($25,000,000.00) of stock represented neither
6 more nor less property than five million dollars ($5,000,000.00) of stock of the National Acme Manufacturing Company. The certificates for one hundred and sixty-seven thousand five hundred dollars ($167,500.00) of stock which plaintiff got in the new company evidenced his ownership of only half of the identical assets evidenced by the certificates for sixty-seven thousand dollars ($67,000.00) of stock which plaintiff held in the old company, and all that plaintiff got by the transactions during 1916 in said The National Acme Manufacturing Company and the National Acme Company in the way of income was two-thirds of the amount of cash which plaintiff received, being two-thirds of one hundred thousand five hundred dollars ($100,500.00). Before the declaration of the stock dividend, the plaintiff's interest in the assets of the National Acme Manufacturing Company was thirty-three thousand five hundred five-millionths ($\frac{33,500}{5,000,000}$). After the stock dividend, plaintiff's interest in said assets was sixty-seven thousand ten-millionths ($\frac{67,000}{10,000,000}$), which is exactly the same. After the reorganization into the National Acme Company, plaintiff had one hundred and sixty-seven thousand five hundred twenty-five millionths ($\frac{167,500}{25,000,000}$), which, when both numerator and denominator is divided by five (5), leaves thirty-three thousand five hundred five-millionths ($\frac{33,500}{5,000,000}$), or sixty-seven ten-thousandths ($\frac{67}{10,000}$), exactly what the plaintiff had before the dividend was declared.

In accordance with the provisions of the Federal income tax law, under section 2 of the act of October 3, 1915, entitled,

"An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the plaintiff, in 1917, duly filed his return of income received during the year 1916. Under compulsion by said defendant, as collector of internal revenue for said
7 Eighteenth District of Ohio, plaintiff was compelled to, and did, file an amended return under protest, and paid the tax, and additional tax, assessed by said defendant, as collector of internal revenue for said district thereon. In determining the amount of taxable income received by the plaintiff during the year 1916, and in ascertaining and fixing the income tax due thereon, the said three hundred and thirty-five (335) shares of the par value of thirty-three thousand five hundred dollars ($33,500.00) of the National Acme Mannufacturing Company, received by plaintiff as such stock dividend, were required by said defendant, as such collector, to be included at eighty-six dollars and fifteen cents ($86.15) a share, or twenty-eight thousand eight hundred and sixty dollars

and twenty-five cents ($28,860.25), and plaintiff was required to, and did return said stock received, growing out of the formation of the National Acme Company, as if it were a sale for thirty dollars ($30.00) per fifty dollar ($50.00) share, or sixty dollars ($60.00) on one hundred dollars ($100.00), when in truth and in fact, at the time said agreement was made, and when said certificates for the capital stock of the National Acme Company were delivered to plaintiff, the stock had not been put upon the market and represented only ownership of the same assets which had been transferred to it by said The National Acme Manufacturing Company, and which, deducting liabilities and patents and good will, represented no more than forty dollars ($40.00) on the one hundred dollars ($100.00), or twenty dollars ($20.00) per share, or, in other words, represented no more than the stock for which it was exchanged, so that there was no profit and no income derived from said transaction of exchanging stock for stock.

Under said ruling said plaintiff was compelled to, and did make the return as set forth in the paper hereto attached, marked "Exhibit B" and made a part hereof. In said exhibit in the first column is placed the return as plaintiff was compelled to make it; in the second column, the return as it should have been made.

On the 27th day of April, A. D. 1917, plaintiff paid to said defendant, as such collector, three thousand four hundred and eighty-four dollars and ninety-three cents ($3,484.93), in payment of income tax, and on the 7th day of June, 1917, the further sum of five thousand nine hundred and thirty-three dollars and nine cents ($5,933.09). Said amended return, and said payment of the 7th of June, 1917, was made under protest in writing, the defendant threatening to
8 enforce the payment of said taxes, together with the penalties and interest, as provided by the act, by distraint and sale of property, and solely to avoid the imposition of penalties, and under compulsion, duress, and coercion.

Thereafter, the plaintiff duly took an appeal to the Commissioner of Internal Revenue, and demanded a repayment of said taxes, in accordance with law and the regulations and the rules of the Treasury Department. Said appeal was duly perfected and filed on the 13th of February, 1919. On the _____ day of _____, 1919, said Commissioner of Internal Revenue overruled said appeal, rejected said claim for repayment, and refused to refund the same, or any part thereof.

Said shares of stock of the National Acme Manufacturing Company, so received by the plaintiff, as aforesaid, on the 10th day of April, A. D. 1916, and said shares of stock of the National Acme Company, did not constitute taxable income under said act of Congress, and no tax was due, or has since become due to the United States Government or to defendant as collector of United States internal revenue for the eighteenth district of the State of Ohio by reason thereof. Said sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84) was illegally

and without warrant or authority of law demanded and collected by the defendant from the plaintiff. No part of said sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84) has been repaid to plaintiff, and the whole amount thereof, with interest thereon from the 7th day of June, 1917, remains due and owing from said defendant to this plaintiff.

This is a suit of a civil nature at common law, and the matter in controversy exceeds, exclusive of interest and costs, the sum of three thousand dollars ($3,000.00), and this suit, and the cause of action herein set forth, arises under the Constitution and laws of the United States, and under the laws of the United States providing for internal revenue. The act of Congress under which said sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84) was levied, and its payment compelled, to wit, section 2 of the act of October 3, 1915, entitled,

"An act to reduce tariff duties and to provide revenue for the Government, and for other purposes,"

is invalid and void, in so far as the same may be asserted to confer power to make such levy, or to compel such payment, because
9 in violation of the provisions of article 1, section 2, clause 3 of the Constitution of the United States, to the effect

"That direct taxes shall be apportioned among the several States,"

and of the provisions of article 1, section 9, clause 4 thereof, to the effect that

"No capitation, or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken,"

and that the said act, as applied to the plaintiff, as aforesaid, did not lay a tax on income within the meaning of the 16th Amendment to the Constitution to the effect that

"The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

and this plaintiff hereby draws in question the constitutionality of said act of Congress, and of all provisions thereof assumed or asserted to authorize the said levy and the enforcement thereof.

Plaintiff therefore prays judgment against the defendant for the sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84), with interest thereon from the 7th day of June, 1917.

WHITE, JOHNSON, CANNON & SPIETH,
Attorneys for Plaintiff.

STATE OF OHIO,
County of Cuyahoga, ss.:

John G. White, being first duly sworn, says that he is the plaintiff in the above-entitled petition, and that the facts therein stated and allegations contained, are true, as he verily believes.

JOHN G. WHITE.

Sworn to before me and subscribed in my presence by the said John G. White, the 24th day of April, A. D. 1920.

[SEAL.] J. E. SPLITTORF,
Notary Public.

10 In United States District Court.

Precipe for summons.

To the Clerk:

Issue summons in the above-entitled cause for defendant, returnable according to law. Endorse: "Amended petition for money only." Amount claimed six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84), with interest thereon from the 7th day of June, 1917.

Dated this 24th day of April, A. D. 1920.

WHITE, JOHNSON, CANNON & SPIETH,
Plaintiff's Attorneys.

In United States District Court.

Exhibit A to amended petition.

This agreement, made by and between W. D. B. Alexander, A. W. Henn, and E. C. Henn, of Cleveland, Ohio, parties of the first part, hereinafter designated as vendors, and Messrs. Eastman, Dillon & Company, of New York, parties of the second part, hereinafter designated as purchasers, is to witness:

That whereas, the vendors are the owners of more than fourteen thousand (14,000) shares of the common capital stock of the National Acme Manufacturing Company of Cleveland, Ohio, organized under the laws of the State of Ohio; and

Whereas, the purchasers desire to acquire the same and such other shares as may be deposited hereunder:

Now, therefore, it is agreed:

First. The vendors agree to and will sell at their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300.00) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth; provided, however, and this contract is made upon the express condition, that it shall not become operative unless, on or before December 1st, A. D. 1916, at least eighty per centum (80%) of the entire outstanding common capital stock of said company is deposited hereunder, for sale in accordance with the terms hereof, with said depositary.

11 Second. Vendors have exhibited to the purchasers the financial statement of said The National Acme Manufacturing Company as of date of September 30th, 1916, and have stated that the combined earnings of its so-called "Windsor plant," recently acquired and its other plants, during 1916, will approximate five millions of dollars ($5,000,000), during the year 1915 were approximately two millions, five hundred thousand dollars ($2,500,000), and during the three years prior thereto, approximately from five hundred thousand (500,000) to eight hundred thousand (800,000) dollars per annum.

The purchasers shall, on or before December 1st, 1916, complete such examination, if any, as they desire to make of the company's books and property, to verify such statements of earnings and financial condition and the title to the company's properties, and shall on or before December 4th, advise the vendors of the result of such examination; and if no examination is made, or unless such examination, if made, disclose that such statements are not substantially correct, or that the titles of its property are defective in some serious respect not readily to be corrected, the purchasers shall proceed to pay for the deposited stock as herein provided. Provided that if the examination made by the purchasers disclose that such statements are not substantially correct, or that the title to its property are defective in some serious respect not readily to be corrected, and the transaction fail for that reason, the depositary shall forthwith return to the purchasers any moneys theretofore deposited by them hereunder, and shall return to the depositors their stock deposited with it.

Third. The vendors will, upon the execution hereof, deliver to the Cleveland Trust Company, of Cleveland, Ohio, as depositary, certificates of all their shares of the said common capital stock, duly endorsed for transfer, and subject the same to the terms of this agreement, and will make an effort to procure the deposit by all the other stockholders of said corporation of certificates of their shares of its said common capital stock, duly endorsed in blank for transfer, with said depositary, subject to the terms of this agreement, and to constitute the vendors, or a majority of them, attorneys in fact and proxies of the depositing stockholders to vote said stock in such manner as may be necessary to carry out the purposes hereof. If and whenever, on or before December 1st, 1916, the depositary shall notify the purchasers that there has been deposited with it at least
12 eighty per cent. (80%) of all said outstanding common capital stock, the purchasers will, within five (5) days from the date of such notice, deposit with said The Cleveland Trust Company, as such depositary, at Cleveland, Ohio, or for its account at the Chase National Bank, in the city of New York, as it may direct, subject to the terms of this agreement, the sum of five hundred thousand dollars ($500,000) in cash, and the further sum of seven millions of dollars ($7,000,000) within ten (10) days from the date of such notice.

Fourth. The purchasers and vendors will cause to be incorporated under the laws of the State of Ohio, a manufacturing corporation,

with generally similar powers to those of said The National Acme Manufacturing Company, under the corporate name of "The National Acme Company," or such other name similar thereto as the parties hereto may desire. Said corporation so to be formed shall have an authorized capital stock of twenty-five millions of dollars ($25,000,000) of common stock, divided into five hundred thousand shares of the par value of fifty dollars ($50.00) each. Upon the organization of said proposed corporation the purchasers and vendors will cause such proceedings to be had by its stockholders and directors as will cause it to purchase all the property and assets of every kind whatsoever of said The National Acme Manufacturing Company, including the good will of its business and subject to all its outstanding contracts and liabilities now or hereafter accrued, which are to be assumed by said new corporation and paid as they mature, in consideration of the sum of twenty-five millions of dollars ($25,000,000), payable by its entire authorized issue of stock, and to issue such stock in payment therefor.

The purchasers and vendors will use their best endeavor to cause such proceedings to be had by the stockholders and directors of said The National Acme Manufacturing Company as will cause all said property and assets, including its good will, to be sold to the newly organized company, at the price and on the terms above set forth, and full title thereto to be vested in that company, and to receive in payment therefor said capital stock of the newly organized company. The purchasers and vendors will cause all the stock of said newly organized company (except nine (9) qualifying shares of directors) to be issued to the Cleveland Trust Company, depositary, or such person as it may nominate, to be held and distributed by it as hereinafter provided.

13 Fifth. Said The Cleveland Trust Company, depositary, shall forthwith distribute said twenty-five millions of dollars (less qualifying shares), par value, of the common capital stock of said new company, and the said sum of seven million, five hundred thousand dollars ($7,500,000), in the following manner, to wit:

(a) If all the common stock of said The National Acme Manufacturing Company has been deposited with it, it will assign and transfer, or cause to be assigned and transferred to the purchasers or their order, one-half, or two hundred and fifty thousand (250,000) shares (excluding four qualifying shares for directors), of said capital stock of said newly organized company, and will, out of said sum of seven million, five hundred thousand dollars ($7,500,000), pay to each depositing stockholder an amount equal to one hundred and fifty dollars ($150.00) upon each share deposited by him. The depositary will, however, retain, with power to vote the same, the remaining one-half, or two hundred and fifty thousand shares (excluding five qualifying shares of said stock), until May 31st, A. D. 1917 (unless and to the extent that the purchasers may consent to earlier deliveries), at the expiration of which time it will assign and transfer, or cause to be assigned and transferred, said shares to the depositing stockholders, or their assigns, pro rata.

(b) If less than the entire amount of the common capital stock of the National Acme Manufacturing Company is deposited hereunder, the depositary shall follow a similar procedure, except that it shall retain ten (10) shares, (five from each one-half above named), of the capital stock of the new company, with power in itself or its nominee to vote the same, and one hundred and fifty dollars ($150.00) in money, on account of each share of stock not so deposited, until adjustment for the purchase of such non-deposited stock, under the laws of Ohio, or otherwise, can be had. The purchasers shall make whatever adjustment may be necessary to acquire such non-deposited stock, and to that end may make use of the shares of stock and money retained by the depositary under the provisions hereof, at the rate of, but not exceeding, one hundred and fifty dollars ($150.00), in cash and two hundred and fifty dollars ($250.00), par value, of said new stock for each of such old stock; and when such non-deposited stocks shall have been acquired by the purchasers, the depositary shall turn over to the pur-
14 chasers any shares or money then remaining in its hands; provided, however, that the vendors, if they desire, shall have the right to participate in the purchase of such non-deposited stock to the extent and upon the terms which may be deemed equitable by Messrs. A. H. Wiggin, president of the Chase National Bank of New York, and F. H. Goff, president of the Cleveland Trust Company, of Cleveland, Ohio; and provided, further, that in lieu of their portion of the retained stock above provided for, the purchasers may substitute and deposit such other collateral as meets the approval of said Wiggin and Goff.

Sixth. The vendors, being the active executive officers of the National Acme Manufacturing Company in the management of its business, hereby agree to accept and retain, if elected thereto, for a period of five years from and after its organization, the same offices or positions therein that they now hold in the present company, or offices or positions involving like duties, it being the desire of both parties hereto that the present management of the business be not interfered with by its transfer to the new company.

Seventh. The purchasers and vendors will, in the organization of the new company, cause its regulations to provide for a board of directors nine (9) in number, of whom four (4) shall be nominated by them and five (5) by the vendors.

Eighth. The purchasers and vendors, further agree that they will cause the new corporation to make application for and use their best efforts to have its stock listed upon New York, Boston, and Cleveland stock exchanges, and the vendors will cooperate with them therein.

Ninth. It is represented by the vendors that the one million, five hundred thousand dollars ($1,500,000), par value, of the outstanding preferred stock of the National Acme Manufacturing Company, has already been called by said company for redemption on January 1st, 1917, at the price of one hundred and five dollars ($105.00) per share and accrued dividends thereon at the rate of six per cent (6%), and they agree that said preferred stock will be in fact retired on or before the consummation of this deal, or that the cash required for such redemption will have been deposited by said company in the Cleveland Trust Company, as provided in the certificates of said

preferred issue as a separate fund for the full redemption of said issue, it being distinctly understood that all, or a portion, of the sum required for such redemption will or may be borrowed by said The National Acme Manufacturing Company for that purpose, and that its liability therefor will be a part of the indebtedness assumed by the new company in the transaction hereinbefore set forth.

Tenth. It is further agreed that during the pendency of this contract, provided the transaction is closed on or before January 1st, 1917, no dividends will be paid on the common stock of the present company other than its regular one per cent (1%) dividend to be declared on December 13th next.

Eleventh. It is further agreed that all the expenses of the formation of the proposed new company, including placing it in such position as to in every way carry out the portions of this agreement devolving upon it, the transfer from the old company to it of its property, the vesting in the new company of full title thereto and the dissolution of the old company, which shall be effected as soon as it legally may, shall be borne by the new company. All expenses, legal or otherwise, incurred by either of the parties hereto, on their own account and for their own benefit, shall be borne respectively by them.

Twelfth. It is further agreed that the Cleveland Trust Company, named as depositary herein, may issue receipts for stocks deposited with it, in accordance with and subject to the terms of this contract.

Thirteenth. The purchasers agree that all things to be done and performed by them will be completed on or before December 31st, 1916, so that the transaction may be closed on or before that date.

Fourteenth. If, in carrying out the terms of this contract, it is deemed desirable to make any modifications therein or additions thereto, the matter shall be submitted to said Messrs. A. H. Wiggin and F. H. Goff, who may make any such modification or addition which they deem advisable or desirable, other than change in price of the stock sold or time of payment therefor, which they have no power to modify.

In testimony whereof, said parties have hereunto affixed their signatures, this 8th day of November, A. D. 1916.

Vendors.

Purchasers.

16 *"Exhibit B" to amended petition.*

INCOME TAX.

For year 1816 as amended, and as it should have been—

	As filed.	Correct.
1. Gross income (brought from line 31)	$183, 161. 79	$91, 191. 29
2. General deductions (brought from line 40)	1, 376. 12	1, 386. 12
3. Net income	$181, 785. 67	$89, 805. 17
4. Dividends brought from line 30	$33, 166. 75	$4, 306. 50
5. Personal exemption (single $3,000; married or head of family, $4,000	3, 000. 00	3, 000. 00
6. Total dividends and personal exemption (items 4 and 5)	36, 166. 75	7, 306. 50
7. Amount of income subject to normal tax	$145, 618. 92	$82, 498. 67
8. Amount of normal tax at rate of 2 per cent on income shown on line 7	2, 912. 38	1, 649. 97
9. Credit by amount of normal tax paid or to be paid at source (1 per cent of amount of income shown on line 25, column A)	1. 50	1. 50
10. Balance of normal tax due	$2, 910. 88	$1, 648. 47

	Income.	Tax.	Income.	Tax.
1% on amount over $20,000 and not exceeding $40,000	20, 000. 00	200. 00	20, 000. 00	200. 00
2% on amount over $40,000 and not exceeding $60,000	20, 000. 00	400. 00	20, 000. 00	400. 00
3% on amount over $60,000 and not exceeding $80,000	20, 000. 00	600. 00	20, 000. 00	600. 00
4% on amount over $80,000 and not exceeding $100,000	20, 000. 00	800. 00	9, 805. 17	392. 21
5% on amount over $100,000 and not exceeding $150,000	50, 000. 00	2, 500. 00		
6% on amount over $150,000	31, 785. 67	1, 907. 14		
11. Total additional tax		6, 407. 14		1, 592. 21
12. Balance of normal tax due		2, 910. 88		1, 648. 97
13. Total tax due		9, 318. 02		3, 241. 18
Tax paid April 27, 1917			$3, 484. 93	
Tax paid June 7, 1917			5, 933. 09	
Total tax paid			$9, 418. 02	
Should have been			$3, 241. 18	
Overpaid			$6, 176. 84	

GROSS INCOME.

	A.	B.	A.	B.
16. Business, trade, commerce, or sales, or dealings in property, whether real or personal		129, 960. 25		67, 000. 00
18. Interest on notes, mortgages, bank deposits, and from all other sources other than reported on lines 19 and 22		1, 861. 68		1, 861. 68
19. Interest on bonds, mortgages, or deeds of trust, or other similar obligations of domestic corporations, joint-stock companies or associations, and insurance companies	150. 00		150. 00	
21. Partnership gains and profits, whether distributed or not		18, 023. 11		18, 023. 11
25. Totals	150. 00	149, 845. 04	150. 00	86, 884. 79
26. Aggregate totals		149, 995. 04		86, 884. 79
27. Dividends on stock of corporations, etc., subject to like tax	33, 166. 75		4, 306. 50	
30. Total dividends		33, 166. 75		4, 306. 50
31. Total gross income		183, 161. 79		91, 191. 29

GENERAL DEDUCTIONS.

33. All interest paid within the year on personal indebtedness of taxpayer	$250. 00	$250. 00
34. All national, foreign, State, county, school, and municipal taxes or taxes imposed by other taxpaying subdivisions of any State, paid within the year, not including those assessed against local benefits	436. 12	436. 12
36. Losses sustained during the year in transactions entered into for profit but not connected with any business or trade (no amount excess of aggregate income from these sources is allowable)	700. 00	700. 00
40. Total general deductions	$1, 376. 12	$1, 386. 12
Should be	$1, 386. 12	

17

In United States District Court.

Amended Answer to Amended Petition.

Filed Nov. 2, 1921.

Now comes E. S. Wertz, United States Attorney for the Northern District of Ohio, and leave of court having been first obtained, files this amended answer in behalf of Harry H. Weiss, Collector of

Internal Revenue for the Eighteenth District of the State of Ohio, defendant, in the above entitled action.

Defendant admits that plaintiff is a citizen of the State of Ohio and a resident of the Eighteenth Internal Revenue District of said State and that at all times mentioned in the amended petition of the plaintiff, defendant was and now is collector of internal revenue for the Eighteenth District of the State of Ohio. Defendant admits that the National Acme Manufacturing Company was during the year 1916 a corporation organized and existing under and by virtue of the laws of the State of Ohio, having an outstanding capital stock of four million ($4,000,000.00) dollars, divided into one million five hundred thousand ($1,500,000.00) dollars of preferred stock and two million five hundred thousand ($2,500,000.00) dollars of common stock, each share being of the nominal or par value of $100.00. Defendant admits that on or about the 15th day of March, A. D. 1916, said National Acme Manufacturing Company declared a stock dividend of 100% and that on said date plaintiff herein was the owner of 335 shares of the common capital stock of the said National Acme Manufacturing Company and that as a result of the declaration of said stock dividend, plaintiff herein became the owner of an additional 335 shares making him the owner of a total number of 670 shares of the common capital stock of the said National Acme Manufacturing Company. Defendant further admits that on or about the 8th day of November, 1916, the officers and stockholders of the National Acme Manufacturing Company entered into the agreement with Eastman, Dillon & Company of New York, copy of which agreement is attached to the petition of the plaintiff herein, and says that by the terms of said agreement said stockholders agreed to sell and said Eastman, Dillon & Company agreed to buy the stock of the National Acme Manufacturing Company for three hundred dollars ($300) per share to be paid as follows: One hundred fifty dollars ($150) in cash and five (5) shares of the common capital stock of a new corporation organized under the laws of the State of Ohio and known as
18 the National Acme Company; that said agreement was carried out by said stockholders of the National Acme Manufacturing Company and said Eastman, Dillon & Company and that pursuant to the terms of said agreement the stockholders of the National Acme Manufacturing Company authorized the execution of a contract dated November 21, 1916, by the terms of which contract the National Acme Manufacturing Company agreed to sell all of its assets and property of every nature to the National Acme Company; that the stockholders of the National Acme Manufacturing Company authorized the sale of all of the assets and property of the company to the National Acme Company and that said authorization was made in the manner and form prescribed by the laws of the State of Ohio, and that as a result of the action of the stockholders of the National Acme Manufacturing Company in so

authorizing the sale of all of the assets of said company, a bill of sale was duly executed by the authorized agents of the National Acme Manufacturing Company on December 4, 1916, by the terms of which bill of sale said National Acme Manufacturing Company sold to the National Acme Company all its property, real and personal, together with all contracts, moneys, accounts, bill receivable, rights, privileges, patents and good will. Defendant says that by reason of the execution of said agreement between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company, and of the subsequent action of said National Acme Manufacturing Company and its stockholders in carrying into effect the terms of said agreement, the plaintiff received one hundred thousand five hundred dollars ($100,500.00) in cash and certificates for 3350 shares of the Common capital stock of The National Acme Company.

Defendant admits that plaintiff filed an income tax return in 1917 purporting to show the income received by plaintiff during said calendar year of 1916 and that this defendant by virtue of his lawful authority compelled the plaintiff herein to file an amended return of the income received by the plaintiff during the said calendar year of 1916 and that in said amended return plaintiff was required to include said 335 shares of the common capital stock of the National Acme Manufacturing Company received by the plaintiff as a stock dividend as aforesaid at $86.15 a share or a total of twenty-eight thousand eight hundred and sixty dollars and twenty-five cents ($28,860.25) and also to include in said amended return said
19 3350 shares of the common capital stock of the National Acme Company received by plaintiff in accordance with said agreement between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company at $30.00 per share.

Defendant admits that the portion of the tax imposed against the plaintiff on said 335 shares of the common capital stock of the National Acme Manufacturing Company received by plaintiff as a stock dividend as aforesaid and returned at $86.15 per share or a total of $28,860.25 was illegally imposed and unlawfully collected; and that as to the sum of $1,731.62, being that portion of the income tax paid by plaintiff upon said shares so received as stock dividend, plaintiff is entitled to apply for and receive a refund as provided in said act of October 3, 1915.

Further answering, defendant says that the transaction between the plaintiff herein as a stockholder of the National Acme Manufacturing Company under said agreement of November 8th, 1916, and Eastman, Dillon & Company was a sale by the plaintiff to said Eastman, Dillon & Company of the stock owned by the plaintiff in said National Acme Manufacturing Company and that said sum of $100,500.00 in cash and said 3350 shares of the common capital stock of the National Acme Company received by the plaintiff from said

Eastman, Dillon & Company in payment for said stock of the plaintiff in the National Acme Manufacturing Company was income under the act of October 3rd, 1915, to the extent that said sum of $100,500.00 in cash and said 3350 shares of the common capital stock of the National Acme Company exceeded the price paid by the plaintiff for his stock in the National Acme Manufacturing Company for so much of the stock as was purchased by plaintiff after March 1, 1913, or the fair market value of said stock of the National Acme Manufacturing Company on March 1st, 1913, for so much of said stock as was purchased prior to said date and was properly taxable as such. Defendant therefore denies that the portion of said income tax paid by plaintiff on said 3350 shares of the comon capital stock of the National Acme Company was illegally assessed and collected. Defendant denies that section 2 of the act of October 3, 1915, is invalid and void or is in contravention of article 1, section 2, clause 3 of the Constitution of the United States or of the provisions of article
20 1, section 9, clause 4, thereof, or of the Sixteenth Amendment thereto, or of any other clause or provision thereof or amendment thereto.

Wherefore, defendant having fully answered, prays that the petition of the plaintiff herein be dismissed and that he may go hence without day.

E. S. WERTZ,
United States Attorney.

[Jurat showing the foregoing was duly sworn to by E. S. Wertz, omitted in printing.]

21 In United States District Court.

Motion for judgment on the pleadings.

Filed Oct. 8, 1921; refiled Nov. 2, 1921.

And now comes the plaintiff, John G. White, by White, Johnson, Cannon & Spieth, his attorneys, and moves the court here for a judgment on the pleadings and for cause of said motion says that the answer filed herein by said defendant to the amended petition of this plaintiff admits the averments of said petition and presents only a question of law as to whether or not, on the averments of the petition, plaintiff is entitled to a judgment and for how much.

WHITE, JOHNSON, CANNON & SPIETH,
Plaintiff's Attorneys.

In United States District Court.

Heard on motion for judgment on pleadings and submitted.

Entered Nov. 10, 1921, by D. C. Westenhaver, Judge.

This day this cause came on to be heard on the motion for judgment on pleadings and was argued by counsel, submitted to the court and taken under advisement by the court.

22 In United States District Court.

Memo. on motion.

Filed Feb. 17, 1922.

WESTENHAVER, District Judge.

This case is before me on plaintiff's motion for judgment on the pleadings. Defendant's answer admits the material allegations of plaintiff's petition and denies none of them except certain conclusions of law. The facts as pleaded are precisely those under consideration in Stearn vs. Weiss, this day decided, except that they are pleaded and set forth in greater detail and that the taxable income is to be calculated on a different basis.

For the reasons set forth in memorandum this day filed in Stearn vs. Weiss, plaintiff's motion for judgment on the pleadings is granted. An exception may be noted. Counsel may calculate the amount of the judgment proper to be entered and submit form of entry.

D. C. WESTENHAVER,
Judge.

February 17, 1922.

23 In the District Court of the United States, Northern District of Ohio, Eastern Division.

Title omitted.

Opinion.

Filed Feb. 17, 1922.

WESTENHAVER, District Judge:

This is an action brought to recover income taxes paid under protest. The parties, by stipulation in writing, have waived their right to a jury trial and have submitted the case to the court in lieu of a jury, upon an agreed statement of facts. The original agreed statement of facts filed herein April 9, 1920, as supplemented and amended by further agreement filed herein November 4, 1921, is adopted as my findings of fact and ordered to be filed as a part of the record. I have given due consideration to the questions involved, but my obligations in other directions are such that I shall do no more by way of opinion than to state briefly my conclusions. Whether or not the plaintiff is entitled to recover depends upon the correct understanding and meaning of the agreement in writing dated November 8, 1916, executed by W. D. B. Alexander, A. W. Henn and E. C. Henn, parties of the first part, and Eastman, Dillon & Company, of New York, parties of the second part. It is the Government's contention that this transaction as therein agreed and as

carried out was in substance and legal effect a sale by the first parties and all of the stockholders of the National Acme Manufacturing Company of their stock in said company, to the parties of the second part, at an agreed valuation of $300 a share, of which $150 was to be paid in cash and the residue in securities of a new and independent corporation to be organized and called The National Acme Company.

This being so, the Government further contends that the profit
24 made by each stockholder on the sale of its stock is income and that the amount of this profit is to be ascertained by adopting $300 a share as the sale price and deducting therefrom the cost to the stockholder of his stock, if bought since March 1, 1913, or the market value on March 1, 1913, if bought before that date. The plaintiff was a stockholder who participated on the basis set forth in said agreement.

All counsel agree that the substance and not the form of the transaction is controlling, and that the court will and must look through the machinery and verbiage in order to ascertain the true substance and nature of the transaction. Having done this, I am of opinion that the contention of the Government is not sound. The real transaction was a sale by the stockholders of the old company to Messrs. Eastman, Dillon & Company of a one-half interest in their shares of stock and a reorganization by the old stockholders and Eastman, Dillon & Company of the corporation, the substance and legal effect of which was to leave all stockholding interests and all the corporate assets in precisely the same situation after the transaction was fully carried out as it was when it was begun. Exhibit A is an agreement not between the old corporation and the new corporation, but between the stockholders of the old corporation and persons desirous of purchasing a one-half interest therein. The parties contemplated an increase of the capital stock from a par value of five million to a par value of twenty-five million and a reduction in the par value of each share from one hundred dollars a share to fifty dollars a share. In actual fact, this is all that was done or accomplished except the purchase by Eastman, Dillon & Company of one-half of the shares of the old company for $7,500,000. In order to accomplish this result and avoid legal difficulties, the transaction, it was contemplated when the agreement was made, was to take the form of a transfer from the old company to the new company of all the corporate assets. The new company was to have the same management and to be chartered for the same objects and purposes and under the laws of the same State. The result in substance and legal effect is the same as if the shares had merely been transferred on the books of the old company to Eastman, Dillon & Company and thereafter an amendment was made and filed to the charter of the old company reducing the par value of each of its shares from one hundred dollars to fifty dollars and increasing the par value thereof from five million to twenty-five million dollars. The
25 only reason why this course was not adopted is that probably greater difficulties would have been encountered in showing

that the new stock to be issued on the basis of five for one had in fact been fully paid up.

All this appears from the terms of the agreement and the agreed statement of facts. The stockholders of the old company, it must be held, sold one-half of their shares of stock to Eastman, Dillon & Company. They received therefor the sum of $150 in cash. They had no option of taking $300 in cash or of getting anything else except an increased number of shares of reduced par value as a result of the changes in corporate form and organization. Neither the new nor the old corporation parted with any of its property as a result of these transactions. The stockholders of the old company received no part of the assets of the old corporation. Nor did said corporation receive anything from the new to distribute from the old as a part of its surplus or capital for distribution among stockholders.

This being the true substance and legal effect of the agreement and of the transactions under consideration, it follows that the income derived or gained by plaintiff, and other stockholders similarly situated, from his stock in the old company or as a result of the sale made thereof, is the cash received by him less the cost of each share to him. Upon this basis it is agreed that the income tax assessed and collected, exceeds what should have been assessed and collected, by the sum of $268.89. Judgment will be entered accordingly. An exception may be noted.

Upon the law as applied to these facts, the case falls within the principles and holdings of the following authorities: Towne vs. Eisner, 245 U. S., 418; Southern Pacific Co. vs. Lowe, 247 U. S., 330; Gulf Oil Corp'n vs. Lewellyn, 248 U. S., 71, 72; Eisner vs. Macomber, 252 U. S., 189; Alpha Portland Cement Co. vs. United States (3 C. C. A.), 261 Fed., 339. See also Montgomery on Income Tax Procedure, Ed. 1918, pp. 95–98.

The case does not, in my opinion, fall within the principle and holdings of the authorities relied on by the Government; namely, Peabody vs. Eisner, 247 U. S., 347; Lynch vs. Hornby, 247 U. S., 339; Rockefeller vs. U. S., decided by U. S. Supreme Court November 21, 1921; United States vs. Phellis, decided by U. S. Supreme Court November 21, 1921.

The principles distinguishing these two classes of cases are definite and well understood. The difficulty, as usual, arises
26 in applying them to the facts of a given case and determining in the light thereof by which set of principles the given case is controlled. The distinguishing characteristic, however, is that the existing corporation must have segregated and placed within the exclusive control of the stockholders some part of its corporate assets, particularly of its profits or accumulated surplus, for, if the dividend is properly to be regarded as a liquidation of capital, then it is not to be regarded as income. In the present case nothing of this kind was done. Plaintiff and stockholders similarly situated, as already said, received purchase money for a sale of their stock from Eastman,

Dillon & Company, but nothing from the corporate assets of either company. Of the cases relied on by the Government, the case closest to the border line upon the facts is the Phellis case, but Mr. Justice Pitney emphasizes the characteristic thus noted as the basis of the court's decision. For instance, the old company, a New Jersey corporation, he says, "had accumulated an excess of assets over liabilities showing a surplus of accumulated profits; the precise amount is not important except that it should be stated that it was sufficient to cover the dividend distribution presently to be mentioned." Of the reorganization or merger of the corporations, he says, "It was a part of the purpose and a necessary result of the plan of reorganization, as carried out, that common stock of the new company to the extent of $58,854,200 should be turned over to the old company, treated by it as assets to be distributed as against its liability to stockholders for accrued surplus, and thereupon distributed to them 'as a dividend.' The assent of the stockholders was based upon this as a part of the plan." And, concluding, he says: "It thus appears that in substance and fact, as well as in appearance, the dividend received by claimant was a gain, a profit, derived from his capital interest in the old company, not in liquidation of the capital but in distribution of accumulated profits of the company; something of exchangeable value produced by and proceeding from his investment therein, severed from it and drawn by him for his separate use. Hence it constituted individual income within the meaning of the income tax law, as clearly as was the case in Peabody vs. Eisner, 247 U. S., 347." An examination of this case thus cited in support, will make plain the ground upon which this case is to be distinguished from the Phellis case.

D. C. WESTENHAVER,
Judge.

February 17, 1922.

27 In United States District Court.

Order of judgment for plaintiff for $8,126.45.

Entered March 31, 1922, by D. C. Westenhaver, Judge.

This cause came on to be heard on the amended petition of plaintiff, the answer of defendant thereto and motion of plaintiff for judgment on the pleadings. The court, being fully advised in the premises, grants said motion and proceeding to ascertain the amount by which the sum paid for income taxes exceeded the amount which should have been exacted, finds, by the agreement of counsel, that the amount of legal income tax which should have been assessed is two thousand nine hundred seventy-one and 90/100 dollars (2,971.90); that the amount which was actually exacted was $9,318.02, of which $3,484.93 was paid on the 27th of April, 1917, and $5,833.09 on the 7th of June, 1917.

It is therefore considered by the court that plaintiff recover of defendant the sum of $8,126.45.

It is further ordered that a certificate issue to said defendant, Harry H. Weiss, of probable cause to collect the amount exacted. Exception is allowed defendant to the findings and judgment of the court.

28 In United States District Court.

Petition for writ of error.

Filed May 13, 1922.

Now comes Harry H. Weiss, defendant herein, and says that on or about the 31st day of March, A. D. 1922, this court entered judgment herein in favor of the plaintiff and against this defendant, in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this defendant, all of which will appear more in detail from the assignment of errors which is filed with this petition.

Wherefore this defendant prays that a writ of error may issue in this behalf out of the United States Circuit Court of Appeals for the Sixth Judicial Circuit for the correction of errors so complained of and that a transcript of the record, proceedings, and papers in this cause, duly authenticated, may be sent to the said Circuit Court of Appeals.

EDWIN S. WERTZ,
U. S. Attorney.
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

29 In United States District Court.

Assignment of errors.

Filed May 13, 1922.

Harry H. Weiss, defendant in this action in connection with and as a part of his petition for a writ of error filed herein, makes the following assignment of errors which he avers were committed by the court in the rendition of the judgment against this defendant appearing upon the record herein, that is to say:

First.

The court erred in granting the motion of the plaintiff for judgment on the pleadings in this cause.

Second.

The court erred in rendering judgment against this defendant upon the granting of plaintiff's motion for judgment on the pleadings.

Third.

The court rendered judgment against this defendant, whereas judgment ought to have been rendered in favor of this defendant and against plaintiff.

Fourth.

The court erred in holding and deciding that the answer of this defendant did not state facts sufficient to constitute a defense to the matters set forth in the petition of the plaintiff herein.

Fifth.

The court erred in allowing interest upon the amount of income tax found to have been overpaid by the plaintiff herein.

Sixth.

The court erred in finding as a basis for granting plaintiff's motion for judgment on the pleadings that the plaintiff sold one-half of his shares of stock in The National Acme Manufacturing Company to Eastman, Dillon & Company and that the only income derived by the plaintiff from his stock in said The National Acme Manufacturing Company, as a result of the sale made thereof, was the cash received by him, less the cost of said shares so sold to plaintiff.

Wherefore this defendant prays that the said judgment may be reversed.

EDWIN S. WERTZ,
U. S. Attorney.
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

30 In United States District Court.

Order allowing writ of error.

Entered May 13, 1922, by D. C. Westenhaver, Judge.

On this 13th day of May, A. D. 1922, the above named defendant, appearing by Edwin S. Wertz, United States attorney for the Northern District of Ohio, and filing herein and presenting to the court his petition praying for the allowance of a writ of error and assignments of error intended to be urged by him, and praying also that a transcript of the record and proceedings and papers upon which the judgment herein was rendered, duly authenticated, be sent to the United States Circuit Court of Appeals for the Sixth Judicial Circuit, and that such other and further proceedings may be had as may be proper in the premises:

Now, on consideration thereof, the court does allow the writ of error as prayed in the petition of the defendant, without bond of the

defendant, it appearing that the above entitled cause is one in which the United States, and not the record defendant, is the real party in interest, and this appeal is being taken by direction of the Department of Justice of the United States of America.

31 *Writ of error.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss.:

The President of the United States to the Honorable the Judge of the District Court of the United States for the Northern District of Ohio, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between John G. White, plaintiff, and Harry H. Weiss, Collector of Internal Revenue for the Eighteenth District of the State of Ohio, defendant, a manifest error hath happened, to the great damage of the said Harry H. Weiss, Collector of Internal Revenue for the Eighteenth District of the State of Ohio, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if the judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said circuit, on the* 11th day of June next, in the said Circuit Court of Appeals to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the United States, the 12th day of May, in the year of our Lord one thousand nine hundred and twenty-two, and of the Independence of the United States of America the one hundred and forty-sixth.

B. C. MILLER,
Clerk of the District Court of the United States for the Northern District of Ohio.
[SEAL.] By M. E. BAUMAN,
Deputy Clerk.

Allowed by
D. C. WESTENHAVER,
Judge of the District Court.

32 [Blank return on writ of error form omitted in printing.]

*Not exceeding 30 days from the day of signing the citation.

33 [Citation in usual form showing service on John G. White omitted in printing.]

34 In United States District Court.

Certificate of probable cause.

Filed May 22, 1922.

Under the provisions of section 989, Revised Statutes of the United States, it is hereby certified that probable cause existed for the collection by Harry H. Weiss, as Collector of Internal Revenue for the Eighteenth Collection District of the United States, located in Cleveland, Ohio, of the income tax in question in the above-entitled cause from the plaintiff herein, and that in so collecting said income tax, said Harry H. Weiss acted under and by direction of the Commissioner of Internal Revenue of the United States.

D. C. WESTENHAVER,
Judge.

35 In United States District Court.

Order extending time.

Filed June 10, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to July 11, 1922.

Enter: _____,
U. S. District Judge.

Order extending time.

Filed July 10, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to August 10, 1922.

Enter: _____,
U. S. District Judge.

36 *Order extending time.*

Filed August 3, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to September 10, 1922.

Enter: _____,
U. S. District Judge.

Order extending time.

Filed September 9, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to September 30, 1922.

Enter: _____,
U. S. District Judge.

37 In United States District Court.

Precipe for transcript.

To the clerk:

Please prepare transcript of record for the Circuit Court of Appeals in the above entitled cause, and include therein the following papers and orders:

Amended petition for money only and precipe filed.
Amended answer to amended petition filed by U. S. Attorney.
Motion of plaintiff for judgment on pleadings refiled.
Heard on motion for judgment on pleadings, taken under advisement ent.
Memorandum opinion of court filed.
Order of judgment on pleadings for plaintiff $8,126.45 exceptions allowed.
Petition for writ of error filed.
Assignment of error filed.
Order allowing writ of error filed and ent.
Writ of error.
Citation.
Certificate of probable cause filed.
And deliver all papers to the Toledo Legal Printing Company for printing.

EDWIN S. WERTZ,
U. S. Attorney,
and BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

38 In United States District Court.

Certificate of clerk.

NORTHERN DISTRICT OF OHIO, ss.:

I, B. C. Miller, clerk of the District Court of the United States for said district, do hereby certify that the annexed and foregoing pages contain a full, true and complete copy of the final record, including the petition for writ of error, assignment of errors, and all proceedings in said cause, in accordance with the praecipe for transcript filed by plaintiff in error, the originals of which are now in my custody as clerk of said court.

There is also annexed to and transmitted with such transcript of record the writ of error and the citation issued and allowed in this case.

In testimony whereof, I have hereunto signed my name and affixed the seal of said court, at Cleveland, in said District, this ------ day of June, A. D. 1922, and in the 146th year of the Independence of the United States of America.

B. C. MILLER,
Clerk,

[SEAL.] By M. E. BAUMAN,
Deputy Clerk.

39 PROCEEDINGS IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Cause argued in part December 6, 1922.

Before DENISON and DONAHUE, Circuit Judges, and PECK, District Judge.

These causes are argued together by Mr. Berkeley W. Henderson, assistant United States attorney, and are continued until tomorrow for further argument.

Further argued and submitted, Dec. 7, 1923.

These causes are further argued by Mr. Berkeley W. Henderson, assistant United States attorney, and by Mr. C. M. Charest, special attorney, Bureau of Internal Revenue, on behalf of the plaintiff in error, and by Mr. John G. White on his own behalf and by Mr. Charles P. Hine on behalf of Louis Stearn, and are submitted to the court.

40 United States Circuit Court of Appeals for the Sixth Circuit.

Judgment.

Filed Jan. 9, 1923.

Error to the District Court of the United States for the Northern District of Ohio. This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Ohio and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

41 Nos. 3759 and 3790.

United States Circuit Court of Appeals, Sixth Circuit.

HARRY H. WEISS, COLLECTOR OF INTERNAL revenue for the eighteenth district of the State of Ohio, plaintiff in error,
vs.
LOUIS STEARN, DEFENDANT IN ERROR.

HARRY H. WEISS, COLLECTOR OF INTERNAL revenue for the eighteenth district of the State of Ohio, plaintiff in error,
vs.
JOHN G. WHITE, DEFENDANT IN ERROR.

Error to the United States District Court for the Northern District of Ohio, Eastern Division.

Opinion.

Filed Jan. 9, 1923.

Submitted December 7, 1922; decided January 9, 1923.

Before DONAHUE and DENISON, Circuit Judges, and PECK, District Judge.

PECK, District Judge: The question involved in these cases is whether the defendants in error were, by the District Court, properly regarded, for the purposes of income taxation under the revenue law of 1916 (39 Stats. 757) as having disposed with profit of only one-half of their respective stock holdings in the National Acme Manufacturing Company, or whether they should have been considered as having so disposed of the entirety.

The transaction in question was had pursuant to a contract between the stockholders and Eastman, Dillon & Company, by the first paragraph of which the former apparently agreed to sell, and the latter to buy, the stock "at and for the price of three hundred
42 dollars ($300) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth." But the real transaction specifically required by the subsequent provisions of the contract and actually consummated was as follows:

The stockholders delivered all of their stock to an intermediary, the Cleveland Trust Company, in trust. For each share so deposited they were to, and later did, receive $150 cash and five shares of new stock of the nominal par value of $50 each, but actually valued at $30 per share for the purposes of the bargain, being, in the aggregate, one-half (250,000 shares) of the stock of a new corporation formed to take over the business. Eastman, Dillon & Company, in order to acquire the other half of the stock of the new corporation, paid to the trustee $7,500,000, being at the rate of $30 per share for 250,000 shares. The vendors and vendees then proceeded to organize the new corporation under the laws of the same State, Ohio, with the same powers and the same name, except for the dropping of the word "Manufacturing." Its capital stock, 25,000,000, was five times that

of the old concern, and was divided into shares of the denomination of fifty, instead of one hundred, dollars each, as theretofore. Accordingly there were ten $50 shares of the new for each $100 share of the old stock. The new corporation issued all of its stock to the trustee in exchange for all the assets subject to the liabilities of the old company. The trustee delivered one-half (250,000) of the shares of the new stock to Eastman, Dillon & Company, in consideration of the $7,500,000 paid in, and distributed pro rata among the old stockholders the other half, 250,000 shares, and the $7,500,000 at the agreed rate of $150 and five shares of the new for each share of the old stock. The old company was then dissolved and the new corporation continued business under the same management.

The net results, putting to one side for the moment the matter of re-incorporation, were that the capital stock of the concern was increased five-fold, the face value of the shares cut in half, and that the old stockholders sold Eastman, Dillon & Company one-half of their respective holdings at the price of $30 per share for the new stock. The income tax on such profit as was made on that half which was so sold was paid by defendants in error, who were among the old stockholders. They were, however, further compelled
43 to pay a like tax because of the receipt of the other half of the new stock in exchange for the old, the Government claiming that they made the same gain thereby as upon the half which they had sold; and for the recovery of this they sued and had judgment below.

It is clear that the half in question was not sold to Eastman, Dillon & Company. This is true despite the above-quoted language of the first paragraph of the agreement, as substance must dominate form; and what was done, rather than what was agreed to be done, is the final criterion. United States *v.* Phellis, 257 U. S. at page 172. As to this half, the legal title never went to Eastman, Dillon & Company, nor beyond the Cleveland Trust Company, which held it for the benefit of the old stockholders, in whom the equity continued, until the agreed equivalent in new stock was delivered to them and the old stock retired by the dissolution of the old corporation. Therefore, if the transaction as to this half resulted in taxable gain at all, it was not as the consequence of any sale to Eastman, Dillon & Company, but must be looked for in the transaction had between the old stockholders, the rustee, and the corporation.

The old corporation went through the form of an exchange of its assets for the new stock and a distribution thereof among its shareholders as upon final dissolution. There was nothing that can be properly called a sale of the half of the stock under consideration in any aspect of the case. The question to be decided resolves itself, therefore, to this: Is there taxable income to the stockholder in the receipt of shares of greater face value and actually worth more than the cost to him of old shares for which they are exchanged upon the occasion of a reorganization accomplished by the taking down of an old corporate structure and the setting up in its place of a new

one with the same powers under the laws of the same State, but having greater capital stock, with a taking over of assets subject to liabilities and a continuance of the business under the same management and name?

It is the present policy of Congress, as shown by the statute now in force, to regard such a transaction as non-taxable (Revenue Act of 1921, ch. 136, p. 230, sec. 202 [c] [2]), although under the act of 1918 the matter had been made dependent upon the comparative face values of the old and new securities (40 Stats. 1060, sec. 202 [b]). The law of 1916, however, under which this case arises, did not deal expressly with exchanges of stock upon corporate reorganizations, and the case is left to be determined upon the general definition of that which is taxable as "including gains, profits and income derived from * * * business, trade, commerce or sales or dealings in property, whether real or personal * * * also from interest, rent, dividends, securities, or the transaction of any businss carried on for gain or profit, or gains or profits and income derived from any source whatever." (Section 2 [a]).

Except for change of corporate entity there was here a continuance of the same concern. The assets were the same, and the stockholders (assuming the sale of the other half to have been consummated) were the same, and in the same proportions: the domicile, the powers, the name, substantially, and the corporate obligations were all left as before. The same ends might have been achieved by an amendment of the articles of incorporation providing for the increase of the capital stock, the reduction of the face value of its shares, and the change of name. Had this method of accomplishing the identical result been pursued, the increase in face value of the new certificates issued to the holders in exchange for the old would have been plainly a mere stock dividend, non-taxable under Eisner *v.* Macomber, 252 U. S. 189. Therefore, if the transaction be taxable it must be because of the giving up of the old and the taking on of the new charter. It is true that a new corporate being has intervened, but where a corporate entity has been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. Southern Pacific Co. *v.* Lowe, 247 U. S. 330; Gulf Oil Co. *v.* Llewellyn, 248 U. S. 71; Alpha Portland Cement Co. *v.* United States, 261 Fed. 339; although it is not so when it is a matter of substance. Eisner *v.* Macomber and United States *v.* Phellis, supra. The latter case, strongly relied upon by plaintiff in error, does not present a parallel situation. There the surplus had been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segragation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capable of returning future dividends to its stockholders. In that state of affairs the Supreme

Court said of the stockholder: "* * * he could sell his entire portion or any of it" (i. e. his dividend) "without parting
45 with his capital interest in the parent company, or affecting his proportionate relation to the interests of other stockholders. Whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest." Rockefeller *v.* United States, 257 U. S. 176, likewise involved a distribution of the stock of a corporation created to take over part of the surplus of the parent corporation while the existence of the latter continued. Peabody *v.* Eisner, 247 U. S. 347, exhibited the case of a distribution, as a dividend, of the stock of another corporation held by the parent company. In each of those cases there was a segregation of accumulated surplus and a distribution of it in the stock of a corporation other than the parent company, both corporations continuing to exist.

In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same enterprise, albeit represented by new certificates, yet essentially the same. For these reasons it is concluded that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income. Accordingly the judgment of the District Court is affirmed.

46 United States Circuit Court of Appeals for the Sixth Circuit.

Clerk's certificate.

I, Arthur B. Mussman, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing is a true and correct copy of the record and proceedings in the case of Harry H. Weiss, collector, etc., vs. John G. White, No. 3790, as the same remains upon the files and records of said United States Circuit Court of Appeals for the Sixth Circuit, and of the whole thereof.

In testimony whereof, I have hereunto subscribed my name, and affixed the seal of said court, at the city of Cincinnati, Ohio, this 20th day of March, A. D. 1923.

[SEAL.] ARTHUR B. MUSSMAN,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

47 *Writ of certiorari and return.*

Filed July 5, 1923.

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America, to the Honorable the Judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Being informed that there is now pending before you a suit in which Harry H. Weiss, collector of internal recenue for the eighteenth district of the State of Ohio, is plaintiff in error, and John G. White is defendant in error, No. 3790, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Northern District of Ohio, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme
48 Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, the twenty-third day of June, in the year of our Lord one thousand nine hundred and twenty three.

[SEAL.] WM. R. STRANSBURY,
Clerk of the Supreme Court of the United States.

In the Supreme Court of the United States, October Term, 1922.

I, Arthur B. Mussman, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the transcript of the record of the proceedings of this court in the within entitled case heretofore certified by me for filing in the Supreme Court of the United States was correct and complete as the same then appeared in this court.

In pursuance of the command of the foregoing writ of certiorari I now hereby certify that on the 3rd day of July A. D., 1923, there was filed in my office a stipulation in the above entitled case in the following words, to wit:

In the Supreme Court of the United States, October Term, 1922.

[Title omitted.]

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above entitled cause that the certified copy of the transcript of the record

now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Sixth Circuit to the writ of certiorari granted therein.

WM. J. HUGHES,
For the Solicitor General.
WHITE, CANNON & SPIETH,
Counsel for Respondent.

June 29, 1923.

I further certify that the above is a true and correct copy of said stipulation and of the whole thereof. Witness my official signature and the seal of said Circuit Court of Appeals at the city of Cincinnati in said circuit this 3rd day of July A. D. 1923.

[SEAL.]

ARTHUR B. MUSSMAN,
Clerk United States Circuit Court of Appeals for the Sixth Circuit.

49 [File endorsement omitted.]

50 [File endorsement omitted.]

○

No. 886

In the Supreme Court of the United States

October Term, 1922.

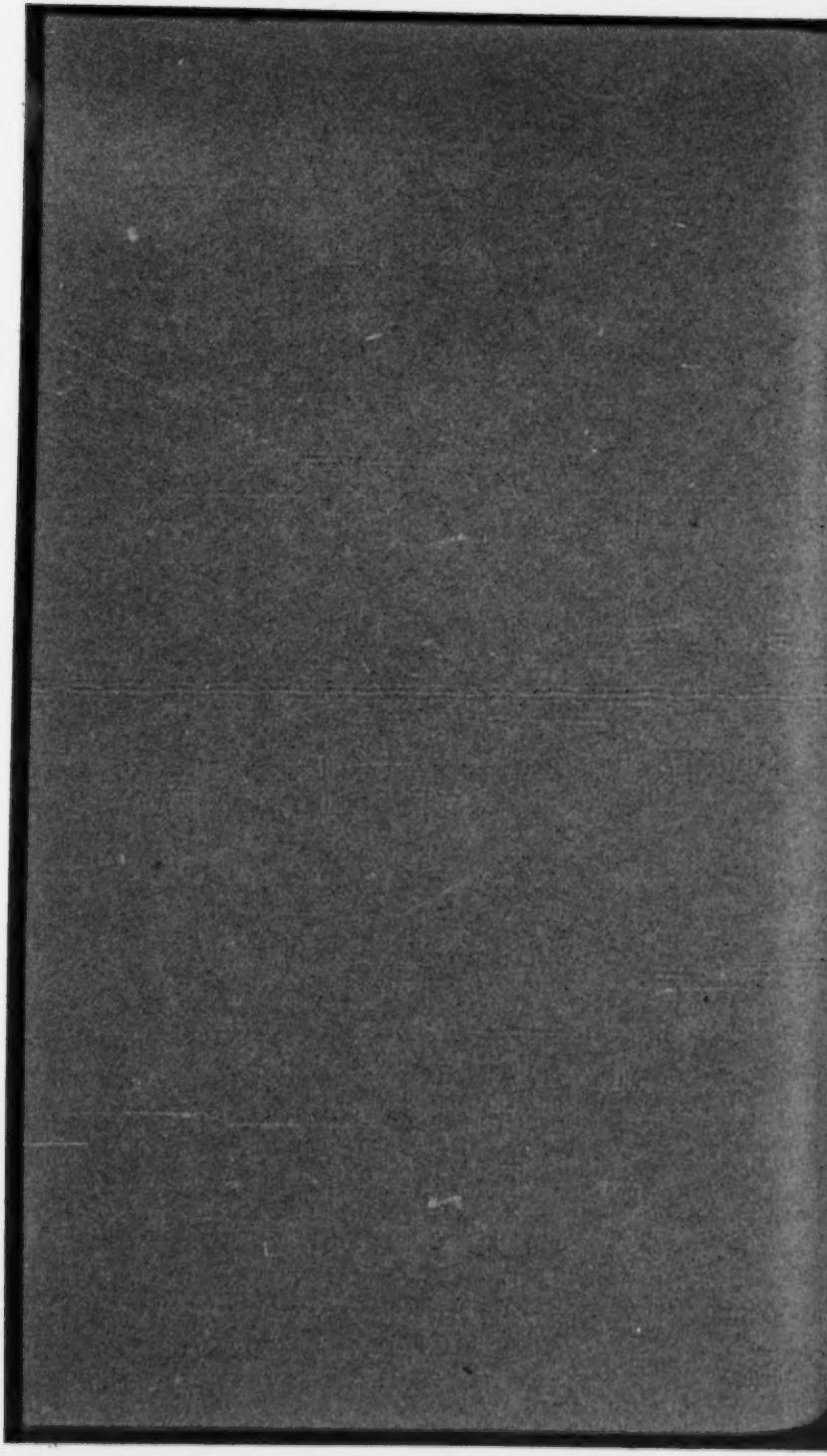
HARRY H. WEISS,
Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

BRIEF FOR RESPONDENT ON PETITION FOR WRIT OF CERTIORARI.

JOHN G. WHITE,
A. V. CANNON,
W. H. ANNAT,
Attorneys for Respondent.



No. .....

In the Supreme Court of the United States

October Term, 1922.

HARRY H. WEISS,
Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

BRIEF FOR RESPONDENT ON PETITION FOR WRIT OF CERTIORARI.

JOHN G. WHITE,
A. V. CANNON,
W. H. ANNAT,
Attorneys for Respondent.

No. .....

In the Supreme Court of the United States

October Term, 1922.

HARRY H. WEISS,
Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

BRIEF FOR RESPONDENT ON PETITION FOR WRIT OF CERTIORARI.

We file this brief chiefly for the purpose of correcting several important inaccuracies in the petition for certiorari, and in the brief in support of the petition.

The facts are these:

In April, 1916, The National Acme Manufacturing Company paid a stock dividend of one hundred per cent. The respondent was compelled to, and did, pay income tax on this dividend. It has been conceded all through the case that the respondent is entitled to recover this back in this proceeding.

The question really in dispute arises out of a transaction had in November and December, 1916, and this question depends entirely upon the construction of a specific written contract made at that time between the representatives of the owners of the capital stock of The National Acme Manufacturing Company and Eastman, Dillon & Company, of New York. The National

Acme Manufacturing Company was an Ohio corporation. It had an authorized capital stock, so far as concerns this case, of five millions of dollars. Its tangible assets, excluding good will and patents, were of the value of at least ten millions of dollars. It had been very prosperous for a number of years, so that its good will, that is to say its expectation of making future profits, was very valuable. The past profits had been invested in the business, which explains the surplus of value of its assets over the amount of its stock.

Under these circumstances, the contract in question was made. It was construed in the same way by both the District Court and the Circuit Court of Appeals. By that contract, as thus construed, and as we claim correctly construed, the stockholders transferred one-half of the stock to Eastman, Dillon & Company for $7,500,000.00 in cash. This gave each of the old stockholders $150.00 a share. They conceded that this was income, and the income tax was paid thereon, and no question arises out of it. The remaining one-half of the stock never passed for a minute to Eastman, Dillon & Company. As a result of the transaction thus far, Eastman, Dillon & Company owned one-half of the stock of The National Acme Manufacturing Company, and the old stockholders retained half of the stock, each stockholder owning exactly half of the stock which he had before. It was further agreed that the old stockholders and Eastman, Dillon & Company, together constituting the whole body of the stockholders of the old company, should organize a new company under the laws of Ohio, under the name of The National Acme Company, so as to retain the good will; that the capital stock of the new company should be Twenty-five Million Dollars ($25,000,000.00), divided into shares of

Fifty Dollars ($50.00) each; that the new company should take over all the assets and liabilities of the old company, and should issue to the stockholders of the old company, made up, as just stated, of the original stockholders and of Eastman, Dillon & Company, all of the stock of the new company in exchange for these assets, and subject to these liabilities; that the old company should be at once dissolved. There were other provisions upon which it is unnecessary to enlarge, providing for the election of a Board of Directors controlled by the old stockholders, retaining the old officers and managers, and obligating the old stockholders not to market their stock for a number of months.

This agreement was actually carried out. The new company was organized according to the agreement; the old company was dissolved, so that never did The National Acme Manufacturing Company and The National Acme Company exist, side by side; never were there at the same time stockholders of the old company and stockholders of the new company; there was never any segregation of assets or of stock; no new capital went into the new corporation; stock was not issued as against any segregated part of the assets nor against profits or surplus. The respondent, after the reorganization and the receipt of his stock in the new company, had precisely the same interest in the same assets, subject to the same liabilities, as he had in the old company, after he had sold half his stock to Eastman, Dillon & Company. The purposes of the two corporations were exactly the same; they existed under exactly the same law and authority. This being true, it is plain that the statements made in the application for the writ of certiorari are incorrect. The stockholders did not sell their stock in The National Acme Manufacturing

Company to Eastman, Dillon & Company; they did not receive from Eastman, Dillon & Company any stock in the newly organized National Acme Company. This incorrect statement is reiterated in the brief, where it is said:

> "The stockholders sold their shares in The National Acme Manufacturing Company for $150.00 cash and five (5) shares of stock in the new company for each share of stock in the old,"

Neither is it true that the undivided interest of the individual stockholder in any surplus has been released to and drawn by him as profit or income from his original capital investment. This is not true, unless *Eisner vs. Macomber,* was incorrectly decided.

Again, it is said in the brief:

> "it is certainly not true that stockholding interests were identical."

It *is* certainly true that stockholding interests were identical. Before the transfer of the assets to the new corporation, the old stockholders owned one-half of the stock of The National Acme Manufacturing Company, and Eastman, Dillon & Company owned the other half. After the transfer, the old stockholders owned one-half of the stock of the new company, and Eastman, Dillon & Company the other half.

It is stated in the petition for certiorari that the decision of the Circuit Court of Appeals is directly opposite to the ruling of the Treasury Department. The actual rulings of the Treasury Department were these: In a letter addressed by Commissioner W. H. Osborn to A. G. Dickson, dated May 3, 1915; *Corporation Trust Company's Income Tax Service* 1916, paragraph 1779:

> "This office is in receipt of your letter of the 21st ultimo, amended by your letter of the 23rd, in

which is presented the following proposition for ruling of this office:

> 'A corporation having a capital stock of $500,000 has accumulated a surplus of $500,000 in addition to paying handsome dividends upon its capital stock. This company proposes to sell, or rather transfer to a reorganized company in which the stockholders and their proportionate interests are the same, all of its assets and good will for $5,000,000 par value of the second company's capital stock. The good will involved in the above proposition has been created entirely by the first company, and the earning capacity of the first company would appear to justify the suggested transaction.'

In reply to your inquiry as to whether or not the difference in the nominal par values of the stocks of the two companies will be treated as taxable income, you are informed that the value of the tangible assets in this case is that represented by the original capital and the surplus of the first company of $1,000,000. Whatever value the business and properties had over $1,000,000 was the value of the good will. Good will is an intangible asset subject to neither appreciation nor depreciation in so far as taxable income is concerned. The conversion of good will into any form of assets other than cash or its equivalent does not constitute income.

In the case cited the $5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater value than is that of the $500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for the assets of the first company is converted into cash or its equivalent, no taxable income will have

> been realized from the transaction. In other words the excess of the nominal par value of the stock issued in payment for assets, over the nominal par value of the stock of the selling company, the stock in both cases being supported by the same assets, does not constitute income within the meaning of the Federal income tax law."

After this decision was made, on the 9th of September, 1916, the Treasury Department reversed this ruling by letter from Commissioner W. H. Osborn, the same Commissioner who made the other ruling, to A. C. Kahn, but prefaced its reversal by saying:

> "In reply your attention is called to Treasury Decision 2274 (Paragraph 1205), a copy of which is herewith enclosed. This decision, you will observe, modified the ruling made in the letter addressed to Mr. Dickson; in fact, according to the last paragraph of this decision, 'all rulings, or parts of rulings, heretofore made, which are in conflict herewith, are hereby revoked'."
>
> *Corporation Trust Company, Income Tax Service* 1917, par. 1217.

So it appears that this decision was based on Treasury Decision 2274. Turning now to Treasury Decision 2274, which is thus the basis of reversal, we find it to be as follows:

> "Stock dividends paid from the net earnings or the established surplus or undivided profits of corporations, joint stock companies or associations, and insurance companies are held to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends."
>
> *Corporation Trust Company, Income Tax Service,* 1917, par. 1205.

This ruling of the Treasury Department, of course, was overruled by the *Macomber* case, and hence the

whole basis for the ruling of September 9, 1916, disappears. But, it is important to thus learn that the basis of the Treasury Department ruling, which your Honors are now asked to sustain, was an opinion of the Department overruled by this Court in the *Macomber* case, and that, in the opinion of the Department, expressed in both rulings, the transaction is merely a stock dividend.

Neither is it accurate to say that in consequence of this ruling of the Treasury Department a large amount of taxes have already been collected. The decisions of the District and of the Circuit Court of Appeals decide not a general question, but a question arising simply on this particular contract, and is as to the construction of *this* contract.

It is, therefore, not accurate to say, as stated in the petition for certiorari,—

> "If the decision stands, numerous other suits may be expected, with strong possibility of conflicting decisions in other circuits."

The decision affects only stockholders in this one company. It is equally inaccurate to say:

> "The question is of grave importance to the administration of the Internal Revenue Laws, which this decision leaves in great confusion."

On the contrary, assuming, as we do, that the construction of the contract by the District Court and the Circuit Court of Appeals is correct, the result necessarily follows under *Eisner vs. Macomber,* and equally under the decision referred to by the Solicitor General, of *U. S. vs. Phellis,* 257 U. S. 156.

Towne vs. Eisner, 245 U. S. 418;

U. S. vs. Alpha Portland Cement Co., 242 Fed. 978;

S. C. 257 Fed. 432;
S. C. 261 Fed. 339.

This was not a case where a corporation, having as part of its assets shares in another company, distributes those shares among other stockholders. *Peabody vs. Eisner,* 247 U. S. 347. Nor yet one where a corporation sells parts of its capital assets and distributes the money among its stockholders by means of a dividend. *Lynch vs. Hornby,* 247 U. S. 339. But rather one like *Southern Pacific Co. vs. Lowe,* 247 U. S. 330; *Gulf Oil Corp. vs. Lewellyn,* 248 U. S. 71, 72. It is sustained by

Phellis vs. U. S., 257 U. S. 156;
Rockefeller vs. U. S.;
New York Trust Company vs. Edwards;

cited by the Solicitor General, all three of which cases distinguish such a case as the one now under consideration.

We repeat, no new assets went into the new corporation; the old corporation at once went out of existence, its stock no longer existed, but there was substituted the stock of the new company. The purposes of the two corporations were the same; they were incorporated under the laws of the same state. It was part of the agreement that the managers of the old company should continue managers of the new company. The name of the new company was such as to retain the good will of the old. After the transaction was complete, there was only one body of stockholders who were the same persons as before the reorganization, owning the same proportion thereof and their stock represented exactly the same property that had been represented by the old stock. The only difference

was that the new corporation was capitalized for a larger amount, (all of the stock of which was issued at once for the old assets) and that the size of the shares was different. There was substantial identity between the old and the new corporation, as determined by all the tests applied in all the cases to which reference has been made.

In the three cases last cited this Court said that where such circumstances existed as exist in this case there was no income created by the transaction.

Thus, the decision in the case under consideration established no new law, but applied the law uniformly declared by this Court to the special circumstances of a particular contract.

Respectfully submitted,

JOHN G. WHITE,
A. V. CANNON,
W. H. ANNAT,
Attorneys for Respondent.

No. 248.

In the Supreme Court of the United States

October Term,
1923.

HARRY H. WHITE, Collector of Internal Revenue,
Petitioner,

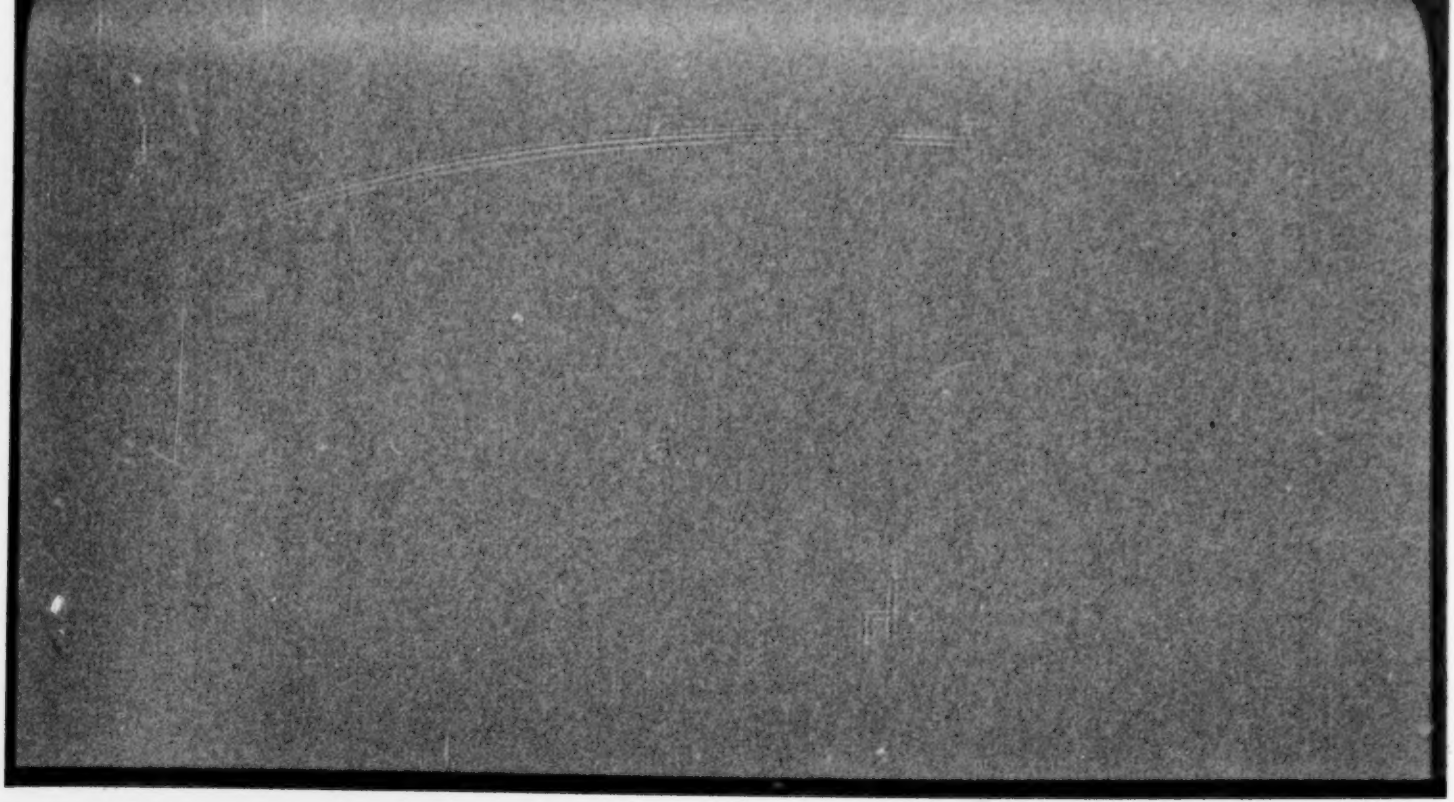
vs.

JOHN G. WHITE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

JOHN G. WHITE,
A. P. CANNON,
L. C. SPIETH,
Attorneys for Respondent.



No. 263.

In the Supreme Court of the United States

October Term,
1923.

HARRY H. WEISS, Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

JOHN G. WHITE,
A. V. CANNON,
L. C. SPIETH,
Attorneys for Respondent.

CASES CITED.

Alpha Portland Cement Co. vs. United States, 261 Fed. 339, 340, *et seq.* 25, 33

Corporation Trust Company, Income Tax Service, 1917, Par. 1217 17

Corporation Trust Company, Income Tax Service, 1917, Par. 1205 18

Crocker vs. Malley, 249 U. S. 223, 233 36

Cullinan vs. Walker, 262 U. S. 134, 137-8 ..... 37, 45, 46

Eisner vs. Macomber, 252 U. S. 189, 206 *et seq.* 15, 18, 19, 25, 33, 41, 42, 55

Gould vs. Gould, 245 U. S. 151, 153 36

Gulf Oil Corporation vs. Llewellyn, 248 U. S. 71, 72 ..... 36, 48, 50, 53

Lynch vs. Hornby, 247 U. S. 339 34

Peabody vs. Eisner, 247 U. S. 347, 349-350 34

Rockefeller vs. U. S., 257 U. S. 176 ..... 37, 43, 44, 45

Southern Pacific Co. vs. Lowe, 247 U. S. 330, 337 ..... 35, 48, 49

Tax Commissioners vs. Putnam, 227 Massachusetts, 522 51

The New York Trust Company, et al., vs. Edwards, Collector 43

Towne vs. Eisner, 245 U. S. 418 18

United States vs. Alpha Portland Cement Co., 242 Fed. 978 25

United States vs. Alpha Portland Cement Co., 257 Fed. 432, 434, *et seq.* 25, 31, 33

United States vs. Isham, 17 Wall, 496, 504 36

United States vs. Mellon, 279 Fed. 910, 914-5 55

United States vs. Phellis, 257 U. S. 156 ..... 37, 38, 39, 43, 44, 45

No. 263.

n the Supreme Court of the United States

October Term,

1923.

HARRY H. WEISS, Collector of Internal Revenue,

Petitioner,

vs.

JOHN G. WHITE,

Respondent.

N WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

The facts are undisputed. The only thing in question is the proper interpretation thereof, and what is e law applicable thereto. Indeed, the applicable law , we think, determined by the interpretation of the cts.

It is conceded that all of the preliminary steps have en taken, enabling respondent to maintain the action.

Two taxes are involved: In April, 1916, The National Acme Manufacturing Company paid a stock dividend of 100 per cent. Respondent was compelled to pay come tax upon this dividend. Petitioner admits that is was erroneous and that respondent is entitled to ve a judgment for the amount he was so compelled pay, with interest. Petitioner states the amount that thinks to be the principal sum to which respondent is

entitled because of the income tax paid on this stock dividend. We have not paused to consider whether this amount is correctly stated, because it is a mere matter of arithmetic, which can be easily agreed to, or if not agreed to, determined by the Court from the agreed facts.

This part of the case is entirely ignored in the brief of petitioner.

Two cases are being heard together, Numbers 262 and 263. This is No. 263. No. 262 is *Harry H. Weiss, Collector of Internal Revenue, Petitioner, vs. Louis Stearn.* These cases differ in two respects:

First: In the *Stearn* case there is no question about the stock dividend of April, 1916. As just remarked, whatever may be the decision as to the other part of the case, respondent is entitled to recover the tax he had to pay because of this stock dividend.

The second difference is that in the *Stearn* case issues were joined and the case was decided on an agreed statement of facts. In the instant case the petition set forth all the facts and the case was determined on a motion by respondent for a judgment on pleadings, which was granted. We believe the petition in the instant case sets forth the facts more at large than is done in the agreed statement of facts in the *Stearn* case, and we therefore, like the Solicitor General, use the record in this case.

The real dispute arises out of a transaction had in November and December, 1916, and this, in its turn, depends, we think, upon the interpretation of an agreement, a copy of which is attached to and made a part of the plaintiff's petition. Before the transaction The National Acme Manufacturing Company was an Ohio corporation. It had stock authorized and issued to the

amount of $5,000,000.00, divided into shares of the par value of $100.00 each. It had assets, excluding good will and patents, of a value of at least $10,000,000.00. This good will and patents were supposed to be of great value. The earnings of the company during the year 1916 approximated $5,000,000.00. During the year 1915 they were approximately $2,500,000.00, and during the three years prior thereto, approximately $500,000.00 to $800,000.00 per annum. (Record, p. 11). It was not a war bride. Its business consisted of manufacturing and selling screw-making machines under the patents owned by it, and of manufacturing and selling screws made by these machines. After the completion of the transaction The National Acme Manufacturing Company ceased to exist, but instead, The National Acme Company had come into existence, an Ohio corporation, having the same corporate powers and purposes as The National Acme Manufacturing Company, with a captial of $25,000,000.00, divided into shares of the par value of $50.00 each. It had exactly the same property and the same liabilities, neither more nor less than The National Acme Manufacturing Company, which property was devoted to the same purposes as it had been when it was the property of The National Acme Manufacturing Company. The process by which this change occurred it is, which gives rise to the question in the case. This transformation occurred through, and in pursuance of, the agreement, a copy of which is marked "Exhibit A" and attached to respondent's amended petition.

The question chiefly depends upon the interpretation of paragraphs of the agreement numbered First, Fourth and Fifth.

We pause here to point out four errors made in the brief of petitioner. As they are several times re-

peated, importance seems to be attached to them. On pages 9 and 10 of petitioner's brief, it is stated:

> "Of course, it is apparent that the purpose of Eastman, Dillon & Company, the purchasers, was to become the owners of a half interest in a very profitable business, and we all know that one who holds fifty per cent. of the stock of a corporation practically controls it, where the other half is held by numerous stockholders."

And on page 10 it is stated that they (Eastman, Dillon & Company) were purchasing the company for the purpose of reorganizing it and placing themselves in control.

And again, pages 19 to 20, speaking of the new corporation, it is said:

> "The real control had passed from him and those with whom he had been associated, and gone to the men who had invested in the enterprise $7,500,000.00 in cash."

(1) It would be something unusual for New York brokers, for the purpose of acquiring a half interest in the business, to invest $7,500,000.00 in an Ohio business into which a very considerable amount of water had just been injected.

(2) Eastman, Dillon & Company confessedly did not invest a dollar in the enterprise. The $7,500,000.00 were paid to the old stockholders. Nothing was taken out of the enterprise by the transaction, not a penny was added to it.

(3) Eastman, Dillon & Company did not acquire control of the business, and the suggestion that they did, because they would hold fifty per cent. of the stock in one ownership, while the old stockholders were numerous, is quite evidently inaccurate in view of a pro-

vision which we shall point out in analyzing the agreement giving Eastman, Dillon & Company the power to market their half of the stock at once, while the depository was not to give the old stockholders their stock until the 31st of May following. As a matter of fact, Eastman, Dillon & Company's stock was all marketed long before the stock certificates were delivered on the 31st of May to the old stockholders. The contract provides that the old stockholders shall have control of the board of directors, and that the old executives shall remain in office and the management be unchanged.

(4) The statement that Eastman, Dillon & Company had at some time during the transaction the ownership of all the stock is equally inaccurate.

That these are errors we think will sufficiently appear from the examination of the agreement which we are about to make.

W. D. B. Alexander, A. W. Henn and E. C. Henn, stockholders, officers, directors and managers of The National Acme Manufacturing Company, and the other stockholders of that Company, were called "Vendors," and Messrs. Eastman, Dillon & Company were called "Vendees." Upon these names, and the first part of the first sentence in Paragraph First, the whole claim of the petitioner stands. We quote the pertinent part:

> "The Vendors agree to and will sell all their said shares of common capital stock to, and the Purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, *subject to the terms of this agreement*, at and for the price of Three Hundred Dollars ($300.00) per

share, payable, one half in cash and one half in securities, *as hereinafter set forth;*" (Record, p. 10)

The petitioner entirely ignores the words italicized.

By Paragraph Third (Record, pp. 11-12), the stockholders agree to deliver to The Cleveland Trust Company, as depositary, certificates of all their stock, endorsed in blank, and subject to the terms of the agreement, and to constitute *the Vendors*, or a majority of them, attorneys-in-fact or proxies of the stockholders, to vote the stock in such way as may be necessary to carry out the purposes thereof. If the transaction was merely a sale by the stockholders of the old company of all their stock to Eastman, Dillon & Company, it is obvious that it would be Eastman, Dillon & Company who would vote the stock, for the stockholders would have ceased to be stockholders. Upon the deposit of at least 80 per cent. of all the outstanding stock, the purchasers were to deposit with The Cleveland Trust Company $7,500,000.00.

By the fourth clause (Record, p. 12), all parties to the agreement, both the so-called purchasers and vendors, that is to say, the stockholders of the Manufacturing Company and Eastman, Dillon & Company, agree to cause to be incorporated, under the laws of Ohio, a Manufacturing Company with similar powers to those of The National Acme Manufacturing Company, under the corporate name of The National Acme Company, that Company to have an authorized capital stock of $25,000,000.00 of common stock, divided into 500,000 shares of the par value of $50.00; that on the organization of such corporation, the purchasers and vendors, that is to say, the old stockholders of the Manufacturing Company, and Eastman, Dillon & Company, were to cause such proceedings to be had by the new Company

that it should purchase all the property and assets of every kind whatsoever of the Manufacturing Company, including its good will, and subject to all its liabilities, which are to be assumed by the new Company and paid as they mature, in consideration of the issue by the new Company of $25,000,000.00 of stock.

We pause here to remark that if title to all of the stock of The National Acme Manufacturing Company had been purchased by Eastman, Dillon & Company, it would have been they alone who would have incorporated the new Company.

The purchasers and vendors, that is, the old stockholders and Eastman, Dillon & Company, will use their best efforts to cause the Manufacturing Company to sell all its assets, including the good will, to the new Company for the capital stock of the newly organized Company, and the two together, that is, the old stockholders and Eastman, Dillon & Company, will cause this stock to be issued to The Cleveland Trust Company, depositary, to be held and distributed as provided in Paragraph 5.

We stop here to call attention to the fact that Eastman, Dillon & Company and the old stockholders are here treated as being stockholders of the Manufacturing Company, and as constituting together the entire body of stockholders of the Manufacturing Company, for, of course, nobody but the stockholders of the Manufacturing Company had any voice in determining whether that Company should sell its property and what it would take therefor. Were it true, as contended by the defendant, that all of the stock in the old Company had been purchased by Eastman, Dillon & Company, they alone would have possessed the power to compel the Manufacturing

Company to sell its assets to the new Company and to make the stipulation that the stock in the new Company should be issued to The Cleveland Trust Company, depositary. It is clear then that title to half of the stock of the old Company did pass to Eastman, Dillon & Company, who enjoyed all the rights arising therefrom, but not for a single instant did title to the other half of the stock of the old Company pass to Eastman, Dillon & Company, and not for a single instant did they enjoy or exercise any control over that half.

From this it is clear that in some way, by the terms of the agreement, Eastman, Dillon & Company are to become stockholders of the Manufacturing Company, and it is further clear that in some way, under the agreement, the old stockholders are to become stockholders of the new Company before the transfer is made.

We also call attention to the evident value placed upon the good will of the manufacturing company. The contract is careful to provide that in the property and assets to be transferred shall be the good will, and to retain that good will the name of the new company, "The National Acme Company," is to be as near to the name of the old company, "The National Acme Manufacturing Company" as possible.

The fifth clause (Record pp. 13-14) provides for what The Cleveland Trust Company shall do, and summarizing only the parts which are applicable to the transaction as it occurred, because all the stockholders of the Manufacturing Company did deposit their stock, The Cleveland Trust Company was first of all to transfer to Eastman, Dillon & Company, or their order, one-half of the stock of the new Company, to pay to the old stock-

holders of the old Company, $7,500,000.00 of cash, which works out $150.00 a share, but to retain the other half of the stock of the new Company with the voting power, until the 31st of May, 1917, at the end of which time it is to issue the other half of the stock of the new Company to the old stockholders, and this works out five shares of the new Company for each one share then owned by the old stockholders after transferring half of their stock to Eastman, Dillon & Company and the same number of shares to Eastman, Dillon & Company for the shares of stock in the old Company owned by them. We point out here that Eastman, Dillon & Company get their stock at once, while the old stockholders do not get their stock until the 31st of May, 1917, thus enabling Eastman, Dillon & Company to market their stock at once, while the old stockholders cannot market their stock until the 31st of May, 1917, five months after Eastman, Dillon & Company have got their stock, and that the half of the stock issued to Eastman, Dillon & Company has only four directors, while the half of the stock issued to the old stockholders has five directors, thus securing to the old stockholders the control of the corporation.

Further carrying out this last purpose, the sixth clause of the agreement, (Record, page 14), provides that the vendors being the active executive officers of The National Acme Manufacturing Company in the management of its business, agree to accept and retain, if elected thereto, for a period of five years after its organization, the same offices or positions which they held in the old company,

> "It being the desire of both parties hereto that the present management of the business be not interfered with by its transfer to the new company."

Still carrying out this purpose of securing to the old stockholders the control of the new corporation, Clause 7, (Record, page 14), provides:

> "Seventh: The purchasers and vendors will, in the organization of the new company, cause its regulations to provide for a board of directors nine in number, of whom four shall be nominated by them and five by the vendors."

Still further carrying out the scheme of enabling Eastman, Dillon & Company to market their stock, the eighth clause (Record, page 14) provides:

> "The purchasers and vendors further agree that they will cause the new corporation to make application for and use their best efforts to have its stock listed upon New York, Boston and Cleveland stock exchanges, and the vendors will co-operate with them therein."

Until Eastman, Dillon & Company became interested in this enterprise, the old stockholders had felt no necessity of having the stock listed on any stock exchange or of having the facilities to market the stock afforded by such listing.

The tenth clause, (Record, page 15) provided that no dividends should be paid between the 1st of January, 1917, and the 31st of May of the same year.

This agreement was carried out. The necessary corporate action was taken by each Company to that effect. The National Acme Manufacturing Company transferred all its assets, including patents and good will, to the new Company, and received therefor, through the depositary, the $25,000,000.00 of stock of the new Company. Eastman, Dillon & Company paid the $7,500,000.00 cash and the new Company assumed all the liabil-

ities of the old Company and acquired all its assets. Half the stock of the new Company was issued to Eastman, Dillon & Company and half the stock was issued to the old stockholders, together with the $7,500,000.00. No dispute arises out of the cash payment. This is conceded to be income, and the income tax arising therefrom has been paid without protest. But the question is, what is the nature of the remaining part of the transaction.

Our contention is that, looking through all the forms and machinery, the real transaction is this: The old stockholders sold half their stock to Eastman, Dillon & Company for $7,500,000.00, and deposited their stock, transferred in blank, with the depositary, subject to this agreement. Thereby Eastman, Dillon & Company became owners of half the stock of the Manufacturing Company and the old stockholders remained the owners of the other half of the stock of the Manufacturing Company. Then the two sets together, thus constituting the whole body of the stockholders of the Manufacuring Company, organized the new Company, and the two sets together constituting the whole body of stockholders of the old Company as such, through the corporate action agreed to be taken by this agreement of the 8th of November, transferred all its assets to the new Company for all the stock of the new Company and its assumption of, all the debts of the old Company. The stockholders of the old Company having thus become the owners of all the stock of the new Company, and it being part of the agreement that this stock shall be divided ratably among the stockholders of the old Company, half of this stock went to Eastman, Dillon & Company, or their nominees, they having become the owners of half of the stock of the old Company. Half of it, of course, went to the

old stockholders of the old Company. This being the nature of the transaction, Eastman, Dillon & Company on the 1st of January, 1917, for their half of the stock of the old company, got half of the stock of the new company or five new shares for one old, and the old stockholders, for each share of the half of the stock of the old Company which they owned, after selling the other half to Eastman, Dillon & Company, got five shares of the new Company, the new Company having exactly the same powers and the same purposes as the old Company, and exactly the same assets and the same liabilites. As a consequence, by this part of the transaction there was neither gain nor loss. Each stockholder simply had a certificate for a larger number of shares than they had before.

There has been no segregation of any of the assets of either the old Company or the new Company, no stock issued against any part of the assets of the old Company or the new Company, but the entire assets of the old Company, without addition or diminution, which before was the property of all the stockholders of the old Company, became the property of all the stockholders of the new Company, and represented by all its stock.

As averred in the petition, and as applicable to the respondent's case, after selling half of respondent's stock to Eastman, Dillon & Company, respondent had left $33,500.00 par value of the stock in the Manufacturing Company. Then for this, he received certificates for $167,500.00 of the par value of the stock of the new Company, evidencing that respondent owned 167,500/25,000,000 of exactly the same property of which, after the sale to Eastman, Dillon & Company of half the stock, he had owned 33,500/5,000,000. If 167,500/25,000,000

be reduced to the denomination of 5,000,000ths, it will be seen that respondent owned 33,500/5,000,000 of the property of the new Company, and as no new funds or property went into the new Company, after the sale to Eastman, Dillon & Company of half the stock, and after getting the stock of the new Company, he had only 33,500/5,000,000 of exactly the same property which he had before he received the certificates for stock, being exactly the same interest in exactly the same property which he had in the old Company. This being true, on the law as we think it is settled by the rulings of Courts, and by the provisions of the amendment to the Constitution of the United States, as interpreted by the courts, respondent derived no income from the exchange of certificates for 33,500/5,000,000 in the old Company for certificates for 167,500/25,000,000 in the stock of the new Company.

Exactly the same result, however, may be reached by another line of reasoning, namely: Treating it as a sale to Eastman, Dillon & Company of the entire stock for $7,500,000.00 of cash and $12,500,000.00 of stock of the new Company, the only profit obtained was from the payment of the cash, for half the stock of the new Company was of precisely the same value as half the stock of the old Company, represented exactly the same assets, the same liabilities, devoted to the same purposes as before, and that hence, so far as the old stock was paid for by the new stock, no profit was made, no gain received, and hence no income.

Taking either line of reasoning,—there was no segregation as to the old stockholders of one-half of their stock of any part of the assets, which all still remained in the corporation, devoted to the same uses and

purposes as before, subject to corporate control, without any power on the part of the owners of the stock to segregate any part thereof without corporate action. We think it is perfectly clear that if the net assets of the old Company were not equal to the par value of the stock of the new Company, issued in payment for such assets, that the stockholders of the new Company, in case of necessity, could be and would be called upon to pay the balance of their stock subscription.

It may further be remarked that the old and the new stock were the same kind of stock, both being common stock.

In applying the law to these facts, we wish to lay emphasis upon certain facts:

(1) The old stockholders had no option as to taking cash, or part cash and part securities. Everyone who came under the agreement had to accept $150.00 in cash *and* five shares of stock of the new Company.

(2) The old stockholders and Eastman, Dillon & Company, together, as stockholders of the old Company, were to cause the old Company to transfer all its property to the new Company.

(3) The old stockholders and Eastman, Dillon & Company, as stockholders of the new Company, were to cause the new Company to accept the transfer of the assets of the old Company for $25,000,000.00 of its stock and the assumption of the debts of the old Company.

(4) No new money or property went into the new Company. Its assets and liabilities were exactly the same as those of the old Company.

(5) No money or property was taken out of the old Company, but all its assets went into the new Company.

(6) The old and new Companies were both Ohio corporations, both had exactly the same powers and the same purposes. All the property of the new Company was devoted to exactly the same purposes and subject to the same corporate control as when it was the property of the old Company, and could not be segregated therefrom by any action of the respondent.

(7) At no time did Eastman, Dillon & Company have control of the entire stock, but throughout the transaction Eastman, Dillon & Company and the old stockholders, concurrently owned each one-half of the stock, first of the old, then of the new corporation.

(8) Eastman, Dillon & Company did not acquire control of the new corporation. That was reserved to the old stockholders by the provision that they could name five out of the nine directors, and that the old executive officers should retain their offices and the management remain the same for five years.

Let us see then what is the law applicable to such a state of facts. Of course, since the decision in *Eisner vs. Macomber*, 252 U. S. 189, it is clear that Congress cannot make that income which is not income; that any law which attempts to do that is unconstitutional, and if the statute, as applied to the facts in the case, tries to make that income which is not in fact income, then it is to that extent unconstitutional.

The case must be determined by the Constitution plus the Act of 1916, under which the rights of the parties became fixed. We are not, therefore, concerned with the provisions of the Act of 1918, though we think that

there can be little doubt that portions of that law are unconstitutional.

The Treasury Department ruled in accordance with our contention, in a letter addressed by Commissioner W. H. Osborn to A. G. Dickson, dated May 3, 1915.

See Corporation Trust Company's Income Tax Service for 1916, Paragarph 1779:

> "This office is in receipt of your letter of the 21st ultimo, amended by your letter of the 23rd, in which is presented the following proposition for ruling of this office:
>
> 'A corporation having a capital stock of $500,000 has accumulated a surplus of $500,000 in addition to paying handsome dividends upon its capital stock. This company proposes to sell, or rather transfer to a reorganized company in which the stockholders and their proportionate interests are the same, all of its assets and good will for $5,000,000 par value of the second company's capital stock. The good will involved in the above proposition has been created entirely by the first company, and the earning capacity of the first company would appear to justify the suggested transaction.'
>
> In reply to your inquiry as to whether or not the difference in the nominal par values of the stocks of the two companies will be treated as taxable income, you are informed that the value of the tangible assets in this case is that represented by the original capital and the surplus of the first company or $1,000,000. Whatever value the business and properties had over $1,000,00 was the value of the good will. Good will is an intangible asset subject to neither appreciation nor depreciation in so far as taxable income is concerned. The conversion of good will into any form of assets other than cash or its equivalent does not constitute income.

In the case cited the $5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater actual value than is that of the $500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for the assets of the first company is converted into cash or its equivalent, no taxable income will have been realized from the transaction. In other words the excess of the nominal par value of the stock issued in payment for assets, over the nominal par value of the stock of the selling company, the stock in both cases being supported by the same assets, does not constitute income within the meaning of the Federal income tax law."

After this decision was made, on the 9th of September, 1916, the Treasury Department reversed this ruling by letter from Commissioner W. H. Osborn to A C. Kahn, but prefaced their reversal by saying:

"In reply your attention is called to Treasury Decision 2274 (Paragraph 1205), a copy of which is herewith enclosed. This decision, you will observe, modified the ruling made in the letter addressed to Mr. Dickson; in fact, according to the last paragraph of this decision, 'all rulings, or parts of rulings, heretofore made, which are in conflict herewith, are hereby revoked.' "

Corporation Trust Company, Income Tax Service, 1917, Par. 1217.

Turning now to Treasury Decision 2274, which is thus the basis of the reversal, we find it to be as follows:

"Stock dividends paid from the net earnings or the established surplus or undivided profits of

corporations, joint stock companies or associations, and insurance companies are held to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends."

Corporation Trust Company, Income Tax Service, 1917, Par. 1205.

This ruling of the Treasury Department, of course, was overruled by the *Macomber* case, and hence the whole basis for the ruling of September 9, 1916, disappears. But, it is important to thus learn that the basis of the contention made in this case by the Government is an opinion of the Department, overruled by this Court, and that in the opinion of the Department in both rulings the transaction is merely a stock dividend.

It is, of course, settled by repeated decisions of both the inferior Federal Courts and this Court that an increase or a decrease of the value of the assets of a corporation is not an increase or a decrease of income of the stockholder until some of the assets of the corporation have been segregated from the property of the corporation and distributed among the stockholders, either in cash or its equivalent, so that it becomes the individual property of the stockholder.

It is impossible to add to the luminous opinion of this Court in *Eisner vs. Macomber,* 252 U. S. 189, as to what is income and when it becomes taxable income, and also to the opinion in *Towne vs. Eisner,* 245 U. S. 418, which is declared by the decision in *Eisner vs. Macomber* not to have been based on the special circumstances of the case, but upon the meaning of the word "income" and the language of the Sixteenth Amendment to the Constitution.

We hope the Court will forgive us for our extensive quotations from the opinion in the *Macomber* case, as it states more concisely and forcibly than we can what we think is the reasoning controlling the case under consideration.

This Court says:

> "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

Again:

> "We find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence vs. Howbert*, 231 U. S. 399, 415; *Doyle vs. Mitchell Bros. Co.*, 247 U. S. 179, 185)—
>
> 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle* case, (pp. 183, 185).
>
> Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy."

Then, after saying that the Government placed chief emphasis upon the word "gain," but overlooked or mis-

conceived the significance of the next three words "derived-from-capital";—"the *gain-derived-from-capital.*"

"Here we have the essential matter: *not* a gain *accruing* to capital, not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being '*derived,*' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal:—*that* is income derived from property. Nothing else answers the description.

The same fundamental conception is clearly set forth in the Sixteenth Amendment—'incomes, *from* whatever *source derived*'—the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution." (The italics are the italics of the Court.)

Again:

"Certainly the interest of the stockholder is a capital interest, and his certificates of stock are but the evidence of it. They state the number of shares to which he is entitled and indicate their par value and how the stock may be transferred. They show that he or his assignors, immediate or remote, have contributed capital to the enterprise, that he is entitled to a corresponding interest proportionate to the whole, entitled to have the property and business of the company devoted during the corporate existence to attainment of the common objects, entitled to vote at stockholders' meetings, to receive dividends out of the corporation's profits if and when declared, and, in the event of liquidation, to receive a proportionate share of the net assets, if any, remaining after paying creditors. *Short of liquidation, or until dividend declared, he has no right to withdraw any part of either capital or*

profits from the common enterprise; on the contrary, his interest pertains not to any part, divisible or indivisible, but to the entire assets, business, and affairs of the company. Nor is it the interest of an owner in the assets themselves, since the corporation has full title, legal and equitable, to the whole. *The stockholder has the right to have the assets employed in the enterprise, with the incidental rights mentioned; but, as stockholder, he has no right to withdraw, only the right to persist, subject to the risks of the enterprise, and looking only to dividends for his return. If he desires to disassociate himself from the company he can do so only by disposing of his stock.*" (Our italics.)

"For bookkeeping purposes, the company acknowledges a liability in form to the stockholders equivalent to the aggregate par value of their stock, evidenced by a 'capital stock account.' If profits have been made and not divided they create additional bookkeeping liabilities under the head of 'profit and loss,' 'undivided profits,' 'surplus account,' or the like. *None of these, however, gives to the stockholders as a body, much less to any one of them, either a claim against the going concern for any particular sum of money, or a right to any particular portion of the assets or any share in them unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose.* The dividend normally is payable in money, under exceptional circumstances in some other *divisible* property; and when so paid, then only (excluding, of course, a possible advantageous sale of his stock or winding-up of the company) does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested." (Our italics.)

This Court then points out that mere book entries do not constitute a gain for the stockholder, nor give rise to taxable income on the part of the stockholder; that they do

> "not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share.
>
> A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. *Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.*
>
> *The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.*" (Our italics.)

Again:

> "We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction."

This Court then says that if he sells, and when he sells, whether dividend stock or original stock, at a profit, he *then* has a taxable income, but that whether he sells dividend stock or original stock,

> "he necessarily disposes of a part of his capital interest, just as if he should sell a part of his old stock, either before or after the dividend. What he retains no longer entitles him to the same proportion of future dividends as before the sale. His part in the control of the company likewise is diminished."

Again, another most important remark of this Court:

> "Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

Again:

> "We have no doubt of the power or duty of a court to look through the form of the corporation and determine the question of the stockholder's right, in order to ascertain whether he has received income taxable by Congress without apportionment.

But looking through the form, we cannot disregard the essential truth disclosed; ignore the substantial difference between corporation and stockholder; treat the entire organization as unreal; look upon stockholders as partners, when they are not such; treat them as having in equity a right to a partition of the corporate assets, when they have none; and indulge the fiction that they have received and realized a shart of the profits of the company which in truth they have neither received nor realized. We must treat the corporation as a substantial entity separate from the stockholder, not only because such is the practical fact but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder. Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while this would be taxable against the corporation as income under appropriate provisions of law, the individual stockholders could not be separately and additionally taxed with respect to their several shares even when divided, since if there were entire identity between them and the company they could not be regarded as receiving anything from it, any more than if one's money were to be removed from one pocket to another."

This Court then says that it does not regard market prices of stock, based upon sales before and after the stock dividends, of any significance, saying:

"But we regard the market prices of the securities as an unsafe criterion in an inquiry such as the present, when the question must be, not what will the thing sell for, but what is it in truth and in essence."

Again this Court says:

> "But an actual cash dividend, with a real *option* to the stockholder either to keep the money for his own or to reinvest it in new shares, would be as far removed as possible from a true stock dividend, such as the one we have under consideration, where nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subjected to their disposal."

Eisner vs. Macomber, 252 U. S. 189, 206, *et seq.*

Counsel for the petitioner seem to have misunderstood some remarks in this case. It is too well settled to require any citation of authorities to establish the fact which is impliedly questioned by the petitioner, viz. that a certificate of stock is merely evidence of ownership by the stockholder of a corresponding undivided interest in the property of the corporation, but most of their reasoning and especially that in the third part of their brief urging the Massachusetts cases seems to be based upon a denial of this established principle.

The case of *United States vs. Alpha Portland Cement Co.*, 242 Fed. 978, s. c. 257 Fed. 432, 261 Fed. 339, is instructive. The District Judge said in the 242 Fed.:

> "From the viewpoint of the taxing authorities the defendant had property which it had acquired at a price, and which it disposed of at an enhanced price, thereby reaping a taxable profit. From the viewpoint of the defendant, the whole transaction was nothing more than a revaluation of the property. The retort of the United States is that the defendant declared it had made a sale of its property at an advance in price, that it received payment at an advanced price, and that it could not have done what it did do, nor have enjoyed the benefits of the transaction, unless the transaction

had in fact been what on its face it was. The defendant in consequence will not be heard to deny that it received the profit it thus is shown to have received."

The defendant company in 1909 bought the Buckhorn property for $415,000.00. It also bought for $416,627.27 a number of shares of the stock of the Catskill Cement Company, together with Letters Patent No. 677,870 issued for an invention. It took title in the name of its President. The defendant company had a capital stock of $2,000,000.00. A plan of reorganization was adopted. This involved, as part of the details, the organization of a subsidiary company, having a capitalization of $2,001,000.00, the $1,000.00 issued for cash and $2,000,000.00 for property. The cash stock was issued to individuals, to whom the stock was nominally issued. The real owner of it was the defendant company. The subsidiary company, the Cement Manufacturing Company, issued its stock to the par value of $2,000,000.00 for a transfer of the Buckhorn property. The $2,000,000.00 of the stock of the subsidiary company went to the defendant company and was distributed by it among its stockholders as a property dividend. The Cement Manufacturing Company and the original company, now the defendant company, were then merged or consolidated under the name of the latter company, and the consolidated company was given a capital stock of $10,000,000.00—this in the form fo $2,000,000.00 preferred and $8,000,000.00 common stock. The $2,000,000.00 of preferred stock was issued to the Cement Manufacturing Company stockholders and the $8,000,000.00 of common to the stockholders of the original defendant company, in exchange for the stock they held of their respective companies. This brought the assets of

the company, as the books of account had been kept, up to the total asset value, as carried on the books of $868,315.01. The Court said:

> "It may help to clarify our view by stating separately the conditions (1) as affecting stockholders; (2) as affecting the company; (3) the transaction as it was; and (4) the transaction as it was made to appear to be.
>
> 1. The stockholders at first held certificates of stock representing shares in the assets of the original defendant company. * * * These assets had been acquired by the company at a cost of $868,315.01, and had been so entered on the books of the company. The certificates of stock, as a mode of expressing the proportionate shares of the stockholders in the assets, represented the entire holdings of the company by the figures $2,000,000, or this was given as the nominal par value of the total number of ownership shares into which its ownership was divided. When the transaction was done, the stockholders had precisely what they had before, so far as ownership of assets goes. The books of account had been rewritten, so as to show that the assets had cost the company $10,000,000 instead of $868,315.01, and the certificates of stock had been reprinted, so as to represent the total ownership, in which the stockholders shared, by the figures $10,000,000 instead of $2,000,000. Intermediately the stockholders, instead of holding certificates of stock in the Alpha Portland Cement Company for $2,000,000, representing the entire ownership in which they shared, held also for an instant of time certificates of stock in the Cement Manufacturing Company for $2,001,000, representing the entire ownership in which they shared the latter company.
>
> 2. At the end of the transaction, the defendant company had precisely what it had before. Its bookkeeping figures had been changed as to the

value of its assets from $868,315.01 to $10,000,000, and there had been a like change in the figures of its capital stock account from $2,000,000 to $10,000,000. The Cement Manufacturing Company had intermediately enjoyed a transitory life of short duration.

3. *The real transaction was nothing more than effecting a reorganization of the defendant company, for the purpose of increasing its nominal capital, in the sense of changing the figures which represented its total stock issue.*

4. The transaction as it was made to appear to be was this: The Company owned the Buckhorn and other property already mentioned. It carried them upon its books at a cost value of $868,315.01. It sold them for $2,000,000, and reinvested the money received in the stock of the Cement Manufacturing Company. It then declared a dividend, payable, not in money, but in this stock of $2,000,000 representing the profit of $1,131,684.99 received on this sale, and the balance received through an enhancement in value of other assets. Its stockholders then exchanged this $2,000,000 of stock in the Cement Manufacturing Company for preferred stock of the defendant merged company of like nominal value."

United States vs. Alpha Portland Cement Co., 242, Fed. 978.

The case then went to the jury. A verdict was found for the Government. Motion for a new trial was filed. The Court at this time said:

"These substantial facts are that a corporation existed, the capital of which it was desired to have increased without any fresh contribution of capital being made by any one. The company owned a property which it had bought at a price, and which was carried on its books as part of its assets at its cost. The property possessed what may be called

the quality of elastic value. As such transactions are viewed, it could be considered as having a value of many times what had been paid for it. *The plan devised was to organize another company with the desired capital, and have the first company sell to the second the property, at a valuation equal to the capital of the latter, which paid for the propery by the issue of its stock.* The two companies were then merged into the present company, which, under the agreement of merger, was given the nominal capital it was planned to have, and the new company assumed all the obligations of the old. What actually and in fact resulted is too obvious to require statement. The bookkeeping result was, however, very different. The facts thus manufactured and made to appear were that the second company, by the formal action of its board of directors and its executive officers, offered to buy of the first company the property mentioned, at a cash price, for real money. This offer the first company, after like formal corporate action, accepted. A conveyance was made on the basis of this consideration having been paid and received. The books of the second company stated that it had paid actual money for the property. The books of the first company showed a corresponding receipt of the same moneys, and, in addition, showed a clear statement of the large profit which had accrued to it. In point of fact, at no time was a dollar handled by any one, or in sight. The facts were all manufactured bookkeeping facts."

The resemblance to the case at bar is obvious, and the difference between the two cases is all in favor of our contention. In our case, there are no bookkeeping recitals of a sale for cash or a receipt of cash. The bookkeeping entries are that the sale was for stock and the receipt was for stock and the preliminary agreement was for stock,—that the sale should be made for stock.

The resemblance between the two cases consists in the fact, on which alone the Government stands in the present case, that a sale was recited, but in the case at bar, the statement of the sale was accompanied by other terms, and qualified and explained by other words, which disclosed that it was not in fact a sale, but a reorganization of the Company.

The Court went on:

> "The argument of counsel for the United States, ably and successfully presented to the jury, was in effect that when a person says he has received moneys by way of profit or income, and states the amount which he has so received, and for what he received it, and the source from which it came, this is evidence against him, and justifies the finding that what he says is true, and that he did receive the profit which he says he received.
>
> This argument, so far as it goes, is unanswerable, and it went far enough to secure this verdict, and would go far enough to sustain it, *were it not for the fact that the mind staggers over giving sanction to a finding that something is true which we know is not true.*"

The Court then says:

> "No one is called upon to pay unless he has the wherewith with which to pay. If the law is construed with these grounds, indicating its policy, in mind, we must construe the words 'income received' as meaning actually received, and not to include something which exists merely as a figment of the imagination.
>
> With this construction given to the act of Congress, the common-sense conclusion is that the exacted tax is not payable."

The Court, while expressing the opinion that there was no taxable income derived from the transaction, yet

refused to order a new trial, to the end that the Government might have, in the reviewing court, whatever benefit might be derived from a verdict in its favor.

United States vs. Alpha Portland Cement Co., 257 Fed. 432, 434, *et seq.*

The case then came before the Circuit Court of Appeals. There the Court stated the facts to be that

> "during the year 1909 the defendant purchased certain properties, the legal title to which was taken in the name of its president, as trustee. Later in the same year, pursuant to a plan for increasing the capital stock of the defendant, these properties were conveyed by the trustee to a corporation known as the Cement Manufacturing Company, which had been formed for the express purpose of thus acquiring and using them in carrying out the recapitalization scheme. The consideration of the conveyance was the issuance by the latter company to the trustee of its entire capital stock, except a few shares necessary, under the laws of the state where the company was incorporated, to be held by the directors. The stock thus issued to the trustee was immediately transferred by him to the defendant, which in turn distributed it among its stockholders, share for share. Thereupon, in furtherance of the recapitalization plan, a merger was effected between the defendant and the Cement Manufacturing Company. For purposes of the merger, the value of properties so conveyed to the Cement Manufacturing Company (which constituted all of its assets) was fixed at the same figure as that at which the trustee had conveyed them to that company; also, before the stock was distributed among the defendant's stockholders it was formally valued by its directors at par. The par value of such stock greatly exceeded the price at which the property had originally been purchased by the defendant. The defendant did not include as income in the tax re-

turn, which it was required by law to make for that year, the apparent profit resulting from the difference between the price which it had originally paid for the properties and the price at which it had ostensibly sold them to the Cement Manufacturing Company. * * *

From the foregoing recital of facts, it is apparent that while, as a matter of form and of bookkeeping, the defendant did realize a very considerable profit during the tax year in question on the purchase and transfer of these properties, yet in reality it made no profit whatever. *The ultimate and real result of the various transactions was that the defendant purchased some properties at one figure, and in working out a plan of recapitalization valued them at a higher figure.* The intermediary corporation, to which the legal title of the properties was conveyed by the trustee, was brought into being by the defendant for the express purpose of working out the recapitalization plan, and ceased to exist as a separate entity after that plan had been carried out. The defendant was no richer after the alleged sale than it was before, notwithstanding the book entries, resolutions of directors, transfers of title, etc. Viewed in this light, we think that it needs no argument to demonstrate that the case falls within the principle of the decisions of the Supreme Court in *Southern Pacific vs. Lowe*, 247 U. S. 330, 38 Sup. Ct. 540, 62 L. Ed. 1142, and *Gulf Oil Corp. vs. Llewellyn*, 248 U. S. 71, 39 Sup. Ct. 35, 63 L. Ed. 133. Indeed, it cannot be distinguished on principle from the decision of this court in *Baldwin Locomotive Works vs. McCoach*, 221 Fed. 59, 136 C. C. A. 660. Under the above stated facts, considered as a whole, the defendant was therefore not liable for the tax which the government sought to recover in this suit."

We stop here to point out the importance of the italicized portion of this opinion in which the Court says

that the arbitrary value put upon the property for the purpose of carrying out the scheme of reorganization has no controlling significance. A similar action in the case at bar is relied upon by the Government, but is entitled to as little significance as in the *Alpha Portland Cement Company* case.

The Court then takes up the contention of the Government that because the evidence showed, by the bookkeeping entries, that a profit had been made by buying at one price and selling at an increased price, therefore it was a question for the jury, and hold that this evidence cannot be taken separate and apart from the rest of the evidence, which showed that these were mere bookkeeping entries, merely made for the purpose of carrying through the reorganization, and could not be detached; that, therefore, the District Court erred in not giving binding instructions to the jury to return a verdict in behalf of defendant, and reversed the judgment.

Alpha Portland Cement Co. vs. United States, 261 Fed. 339, 340, *et seq.*

We call attention to the significance of this holding as bearing upon the contention of the Government that the statement of purchase in the agreement of the 8th of November is controlling.

We now call attention to the two decisions of this Court referred to in this latter opinion.

Referring to the facts in the case at bar, it will be seen that there is no segregation of the assets of The National Acme Manufacturing Company. They remain together, in the language of the Supreme Court in the *Macomber* case, subject to the same purposes, to be used in carrying out the same objects as before, and without the interest of the plaintiff therein being in any way seg-

regated. As said by this Court in the *Macomber* case, there might be a dividend which would give rise to income, although it was not a cash dividend, if it was made by segregation of the assets of the Company. We may, therefore, distinguish those cases in which a corporation, having as part of its assets, shares in another Company, distributes those shares among its stockholders.

Peabody vs. Eisner, 247 U. S. 347.

In the last mentioned case, the Union Pacific Railroad Company, as part of its assets, owned stock of the Baltimore & Ohio Railroad Company. It declared a dividend of $3.00 in cash, $12.00 in par value of preferred stock of the Baltimore & Ohio, and $22.50 in par value of the common stock of the same company. This Court held that by this dividend, payable in stock of the Baltimore & Ohio Railroad, the plaintiff got income, saying,—

> "that this case is not ruled by our decision in *Towne vs. Eisner,* since the dividend of Baltimore & Ohio shares was not a stock dividend but a distribution *in specie* of a portion of the assets of the Union Pacific, and is to be governed for all present purposes by the same rule applicable to the distribution of a like value of money."

Peabody vs. Eisner, 247 U. S. 347, 349-50.

So in *Lynch vs. Hornby,* a Lumber Company sold part of its capital assets for money and divided that money among its stockholders by means of a dividend, and the Court held that the profit arising from the increase in value of the property thus turned into money and distributed among its stockholders, constituted taxable income.

Lynch vs. Hornby, 247 U. S. 339.

In each of these cases part of the assets had been segregated and thus diverted from the purposes of the corporation and divided among the stockholders.

On the other hand, in *Southern Pacific Co. vs. Lowe*, where the two corporations were in fact identical, *though in legal contemplation separate entities*, it was held that the allotment of stock did not create income.

Southern Pacific Co. vs. Lowe, 247 U. S. 330.

A case similar to the last in principle is *Gulf Oil Corp. vs. Llewellyn*. In that case, a subsidiary company and the holding company together constituted a single enterprise, carried on by the Gulf Oil Corporation, of producing, buying, transporting, refining and selling oil. The Gulf Oil Corporation took over, in January, 1913, all the earnings and surplus of the subsidiary companies. This Court says:

> "But disregarding the forms gone through, the result was merely that the petitioner became the holder of the debts previously due from one of its companies to another. It was no richer than before, but its property now was represented by stock in and debts due from its subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books. * * * It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the facts that they were related as parts of one enterprise, all owned by the petitioner, that the debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as 'dividends declared and paid in the ordinary course by a corporation.'"

Gulf Oil Corp. vs. Llewellyn, 248 U. S. 71, 72.

It is, of course, well settled that where there is doubt in the construction of a tax law, that these doubts should be resolved in favor of the taxpayer and against the Government. This Court said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen. *United States vs. Wigglesworth*, 2 Story, 369; *American Net & Twine Co. vs. Worthington*, 141 U. S. 468, 474; *Benziger vs. United States*, 192 U. S. 38, 55."
>
> *Gould vs. Gould*, 245 U. S. 151, 153.
>
> *Crocker vs. Malley*, 249 U. S. 223, 233, citing *Gould vs. Gould*, *United States vs. Isham*, 17 Wall, 496, 504.

We repeat that in the case at bar, the new corporation took over all the assets and liabilities of the old corporation and issued therefor its stock. No new assets went into the new corporation; no new liabilities were created. The old corporation went out of existence, its stock no longer existed, but there was substituted the stock of the new company. The purposes of the two corporations were the same; they were incorporated under the laws of the same state. It was part of the agreement that the managers of the old company should continue managers of the new company. The name of the new company was such as to retain the good will of the old. After the transaction was complete, as before, there was only one body of stockholders,

and their stock represented exactly the same property that had been represented by the old stock. The only difference was that the new corporation was capitalized for a larger amount, (all of the stock of which was issued at once for the old assets) and that the size of the shares was different. There was substantial identity between the old and the new corporation.

The rule deducible, we think, from these cases is, that if there is a substantial identity between the two corporations, that nothing has been added, nothing has been substracted from its property; if the old corporation ends simultaneously with the beginning of the new corporation, both corporations have the same powers, are incorporated in the same State, are carrying on the same enterprise; if the interest of each stockholder remains the same in the new corporation as in the old; if there has been no segregation of profits, but all the profits still remain invested in the business, so that therefore the stockholder cannot dispose of any of his stock without diminishing his share in the corporation; that in such cases just stated, there has been no income derived. The pivotal point, as we see it, is: Has there been any segregation of the property of the corporation; has any stock been issued specifically for profits or for property representing profits, or as representing specific parts of the property of the corporation, so that by selling such stock thus segregated, the stockholder can realize his profit and preserve his proportional interest in the enterprise unimpaired? We do not think that any of the cases cited by counsel for petitioner in any way contravene this principle.

Counsel rely upon the cases of *United States vs. Phellis*, 257 U. S. 156; *Rockefeller vs. U. S.*, 257 U. S. 176; *Cullinan vs. Walker*, 262 U. S. 134.

Bearing in mind the facts and the principles just stated, let us examine these cases and their *ratio decidendi.*

Stating the facts in the *Phellis* case this Court said:

> "Each holder of the New Jersey Company's (the old company) common stock (including claimant), *retained his old stock* and besides received a dividend of two shares for one in common stock of the Delaware company (the new company), and the New Jersey corporation (the old company) retained in its treasury 6 per cent. debenture stock of the Delaware corporation (the new company) equivalent to the par value of its own outstanding common stock. * * * After the reorganization and the distribution of the stock of the Delaware corporation (the new company), the New Jersey corporation (the old company) continued as a going concern, and still exists. * * * It is not, however, in process of liquidation. It has received as income upon the Delaware company's debenture stock held by it, dividends to the amount of 6% per annum, which it has paid out to its own stockholders including the claimant. * * *" (page 167)

Then proceeding to reason upon these facts, this Court said:

> "The *common stock* of the *new company*, after its transfer to the old company and prior to its distribution, constituted assets of the old company which it *now held* to represent its surplus of accumulated *profits.*" (p. 170)

Thus stressing that the surplus of accumulated profits was segregated into the stock of the new company. In the case at bar there was no stock of the new company issued as against the surplus or accumulated profits, and there was no segregation of accumulated profits into stock. Each share of the *new stock* represented

exactly the same thing that each share of the *old stock* represented. This Court further said:

> "still however a common fund in which the individual stockholders of the old company had no separate interest. But when this common stock was distributed among the common stockholders of the old company as a dividend, then at once—unless the two companies must be regarded as substantially identical—the individual stockholders of the old company, including claimant, received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit."

In the *Phellis* case, the old and the new corporation continued to exist side by side. They were not substantially identical. They were distinct corporations, intended to remain distinct corporations, and the stock of the new corporation represented exclusively the surplus of accumulated profits of the old company, and these had been severed from the capital interest in the old company. In the case at bar, contemporaneously with the distribution of the stock in the new company, the stock in the old company ceased to exist, and the old company ceased to exist. There was no severance of the stock and assets of the new company from the stock and assets of the old company. One represented the other instead of continuing to exist side by side.

This Court then rejected the use of the market value of the stock as an indication of whether or not there had been an income, and then proceeds to discuss the question of whether there was a substantial identity between the old company and the new company. This Court says that there was not a substantial identity be-

tween the two companies. Let us see what they point out as showing that there was not a substantial identity —but we pause here to remark that this portion of the reasoning of the Court would have been unnecessary had it not been true, in the opinion of the Court, that if there was a substantial identity between the old and the new corporation, then the result should have been different from what it actually was. The case therefore is a direct authority against petitioner's third claim that the mere fact of the intervention of a new company of itself creates income. This Court says:

> "The plan as thus proposed and adopted, and as carried out, involved the formation of a *new corporation* to take over the business and the business assets of the old; it was to be and was formed under the laws of a *different State*, which necessarily imports a different measure of responsibility to the public, and presumably different rights between stockholders and company and between stockholders *inter sese*, than before."

Then after saying that they would assume that there was no difference between the articles of association, the Court proceeds:

> "But the new company was to have authorized capital stock aggregating $240,000,000—nearly four times the aggregate stock issues and funded debt of the old company—of which less than one-half, ($118,515,900) was to be issued presently to the old company or its stockholders, leaving the future disposition of a majority of the authorized new issues still to be determined."

In the case at bar, all of the stock of the new company was issued at once to the old company to be distributed by it in exchange for the old stock. Proceeding the Court says:

> "There was no present change of officers or stockholders, but manifestly a continuation of identity in this respect depended upon continued unanimous consent or concurrent action of a multitude of individual stockholders actuated by motives and influences necessarily to some extent divergent."

In other words, the old and the new corporation continuing to exist side by side, the continuance of identity of stockholders and the management of the old and the new corporation depended upon what might be the divergent action of the members of the two corporations. A sufficient number of the stockholders of the new corporation, for instance, might sell their stock to introduce a majority of new stockholders in the new corporation, while the old stockholders retained their stock in the old corporation, or vice versa, and in either case, the two corporations continuing to exist side by side, there would be a diversity of interest, a diversity of membership, a diversity of control, a diversity of policy. In the case at bar the old corporation having ended there could be no transfer of stock in one corporation while stock in another corporation remained the same, there could be nothing but the ordinary change of membership of one and the same corporation, a change which, in *Eisner vs. Macomber,* was held to be no reason for declaring a stock dividend to be income. This Court proceeds:

> "In the light of all this we cannot regard the new company as virtually identical with the old, but must treat it as a substantial corporate body with its own separate identity, and its stockholders as having property rights and interests materially different from those incident to ownership of stock in the old company.
>
> "The findings show that it was intended to be established as such, and that it was so created in fact and in law. There is nothing to warrant us in

> treating this separateness as imaginary, unless the identity of the body of stockholders and the transfer *in solido* of the manufacturing business and assets from the old company to the new necessarily have that effect. But the identity of *stockholders was but a temporary condition, subject to change at any moment at the option of any individual.''*

Necessarily, in view of the ruling in *Eisner vs. Macomber,* this depends upon the continued existence of the two corporations, for, of course, where there is a stock dividend which was held not to create income, in *Eisner vs. Macomber,* there may be a change in the stockholders, dependent upon the will of any stockholder. Therefore, this in and of itself is not what the Court means, but what it does mean is that the identity of the stockholders in the still subsisting two corporations may be changed at will. Again, the Court lays stress upon the fact that the new stock represented only accumulated surplus. They say:

> ''It was a part of the purpose and a necessary result of the plan of reorganization, as carried out, that common stock of the new company to the extent of $58,854,200 should be turned over to the old company, treated by it as *assets to be distributed as against its liability to stockholders for accrued surplus, and thereupon distributed to them 'as a dividend.'* The assent of the stockholders was based upon this as a part of the plan.
>
> ''In thus creating the common stock of the new company and transferring it to the old company for distribution *pro rata* among its stockholders, the parties were acting in the exercise of their rights *for the very purpose of placing the common stockholders individually in possession of new and substantial property rights in esse, in realization of their former contingent right to participate eventually in the accumulated surplus.''*

Speaking of the stock of the new company, this Court said:

> "There was neither express nor implied condition, arising out of the plan of reorganization or otherwise, to prevent any stockholder from selling it; *and he could sell his entire portion or any of it without parting with his capital interest in the parent company, or affecting his proportionate relation to the interests of other stockholders,* whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest."

It will thus be seen that the entire *ratio decidendi* of this decision was predicated upon two propositions. The first and most fundamental, the continued existence of the old company after the new company was formed. It was part of the plan that the old company should continue to exist and to function. Second, that the stock in the new company was issued against surplus profits, thus segregating the stock representing surplus profits from the portion of the stock representing assets of the company that was not surplus funds, and enabling the stockholder, by selling the new stock, to realize upon his share of the surplus profits of the old company.

Upon these two facts are based the whole law and gospel of the decision in *United States vs. Phellis.*

We may deal more shortly with the other two cases which are reported together, *Rockefeller vs. The United States of America* and *The New York Trust Company, et al., vs. Edwards, Collector.* In these cases, as in the *Phellis* case, the old corporation and the new corporation continued to subsist side by side. In these cases,

as in the *Phellis* case, a certain part of the property was segregated and represented by the stock of the new Company. In the *Phellis* case, the surplus profits of the old Company were segregated. In the *Rockefeller* and *New York Trust Company* cases, certain of the tangible assets were segregated. In the *Rockefeller* case, as in the *Phellis* case, the stockholder, by selling his new stock, could realize upon that part of the assets which was thus segregated, without in any way taking anything from his ownership in the old company. In the *Phellis* case, as in the *Rockefeller* case, by the formation of the new company, a portion of the property of the old company was segregated from the remaining property of the old company and represented by the new stock. In the case at bar, there is no segregation. We insist that the reasoning of this Court in all three of these cases impliedly sustains our position; that it impliedly holds that there is no income, inasmuch as the new company is a substitution for the old company, as it takes its place in every respect as to property and as to stockholders, the stock representing the same assets, the same liabilities, and owned by the same individuals, so that there is no segregation of assets by the creation of stock against segregated assets, no creation of a body of new stockholders distinct from the body of old stockholders, no creation of a single stockholder who was not a stockholder of the old company and holding the new stock in exactly the same proportion as the old; so that after the transaction was complete, each stockholder having ceased to hold any old stock and holding only new stock, by virtue of his holding his new stock in the same proportion which *he had* formerly held the old stock, owned exactly the same proportion of the property of the new company as he had before.

The reasoning of this Court manifestly holds that when there is a substantial identity between the new company which has come into existence and the old company which has gone out of existence, and an identity of the stockholders and an identity of the proportionate ownership, that then no rights have been created, no income created, no income tax liability exists.

The last case in this Court cited by petitioner is *Cullinan vs. Walker*, 262 U. S. 134.

This too, we think, fails to assist petitioner. The facts in the case were that the Farmers Petroleum Company, a Texas corporation, was both a producing and a pipe line company. In 1915 it was dissolved under the Texas law. Trustees in liquidation were appointed. In 1916 the trustees organized two Texas corporations, The Republic Production Company, a producing concern, and The American Petroleum Company, a pipe line concern. To these corporations the trustees assigned, to the one, the producing assets, to the other, the pipe line assets, equal in value. From each they received $1,500,000.00 par value of stock and $1,500,000.00 par value of bonds, being the total issues. Suppose the transaction had stopped here and the trustees had distributed the stock and bonds pro-rata to the stockholders in the Farmers Petroleum Company. Very obviously the case would have been ruled by the *Phellis* and *Rockefeller* cases. As pointed out in those cases, the temporary identity of stockholders and officers would not necessarily last. In time the stockholders of each would change and the corporations become as divergent as if they had not had a common origin. But, as if to liken the case more closely to the *Phellis* case, the trustees did not stop here. They organized the American Republics Corporation under the laws of Dela-

ware, a holding company. To it the trustees transferred all the stocks of the two new Texas corporations, and from it they received $3,000,000.00 of the stock of the Delaware corporation, so that they held, at the same time, the $3,000,000.00 of stock of the Delaware corporation and the $1,500,000.00 of bonds of the Texas corporations. All this was distributed pro-rata among the stockholders of the Farmers Petroleum Company. The part of the decision here important is not quoted by the petitioner in their brief. We think it is the following:

> "The corporation, whose stock the trustees distributed, was a holding company. In this respect, it differed from Farmers Petroleum Company, which was a producing and pipe line company. It differed from the latter, also, because it was organized under the laws of another State. It is true that, at the time this Delaware corporation's stock was distributed, it held the stock of the new oil producing company and likewise the stock of the new pipe line company. *But the Delaware corporation was a holding company. It was free, at any time, to sell the whole, or any part of the stock in either of the new Texas companies and to invest the proceeds otherwise. By such a sale, and change of investments, all interest of the holding company in the original enterprise might be parted with, without, in any way, affecting the rights of its own stockholders.*" (Our italics).
>
> *Cullinan vs. Walker*, 262 U. S., 134, 137-8.

What we have just said as to the holdings of this Court suffices to dispose of the two Massachusetts cases cited by counsel for petitioner. In the *Osgood* case, stock in one corporation was exchanged for stock in another corporation.

The *Osgood* case was a case not of an income tax but of a tax on purchases. With great deference to that

learned court, it is difficult to follow the reasoning of the Supreme Court of Massachusetts when it indicates that the word "purchase" is a broader word than the word "sale." They seem to us to be correlative terms. Where there is a sale there must be a purchase. Where there is a purchase there must be a sale. In the *Osgood* case the petitioner owned 1,300 shares of the preferred and 1,000 shares of the common stock of the Draper Company, which had outstanding preferred stock of the par value of $2,000,000.00, and common stock of the par value of $6,000,000.00. This was exchanged for stock in the Draper corporation, all of whose stock was common and of the par value of $17,500,000.00, 2½ shares were given for each share of the common stock of the old company and 1¼ shares for each share of the preferred stock of the old company. The Court seems to lay some stress upon the fact of a change in the kind of stock, as they recur several times to the fact that the new stock was not of the same kind as the old stock. We are not able to determine whether this was, in the opinion of the Court, an essential part of the basis of the decision. Aside from this, the *ratio decidendi* was that the two stock corporations were different legal entities, and, therefore, that the exchange of the stock of one for that of the other was necessarily a purchase, regardless of the question of the actual identity of the two corporations. Under this reasoning, every re-organization of a corporation effected by means of organizing a new corporation would necessarily be a purchase and give rise to gain or income. This is a proposition which has always been repudiated by the Commissioner of Internal Revenue, has never been approved by the Federal Courts, and is repudiated by this Court, as indicated by the authorities already cited.

We think that to these may be added on this point *Southern Pacific Co. vs. Lowe,* 247 U. S. 330 and *Gulf Oil Corporation vs. Llewellyn,* 248 U. S. 71.

We do not cite these last two cases as authorities to any but the one proposition, as to whether the fact of the two corporations being distinct legal entities is sufficient of itself to create income as a consequence of the transfer of stock.

In the *Lowe* case the *Southern Pacific Company,* a Kentucky corporation, owned all the stock of the Central Pacific Railway Company, a Utah corporation. The Railway Company was the successor of the Central Pacific Railroad Company and acquired all its property, which constituted a part of a large system of railways owned and controlled by the Kentucky company. The predecessor of the Utah Company had leased its railroads to the Kentucky Company and this lease had been assumed by the Utah Company. The Kentucky Company, besides being sole stockholder, was in the actual physical possession of the railroads and all other assets of the Utah Company, and in charge of its operations under the lease. The result was that while the two corporations remained distinct legal entities, the dealings back and forth, between them, were substantially bookkeeping entries. The result was that the books of the Utah Company showed a large surplus, accumulated prior to January 1st, 1913, principally in the form of a debit against the Kentucky Company, which, at the same time, as sole stockholder, was entitled to any and all dividends that might be declared, and being in control of the Board of Directors, was able to and did control the dividend policy. Dividends were declared and paid, but the payment was only made by bookkeeping entries, which simply reduced the apparent surplus of the Utah

Company and reduced the apparent indebtedness of the Kentucky Company to the Utah Company by precisely the amount of the dividends. This Court held that these dividends were not income because of

> "the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control."
>
> *Southern Pacific Co. vs. Lowe,* 247 U. S. 330, 337.

The Gulf Oil Corporation was a New Jersey corporation. It owned all of the capital stock of the J. M. Duffie Petroleum Company, The Gulf Pipe Line Company, The Gulf Pipe Line Company of Oklahoma, The Indiana Oil & Gas Company and the Gulf Commissary Company. These were all separate and distinct corporations apparently under the laws of different States, separate and distinct legal entities. All these companies constituted a single enterprise, carried on by the Gulf Oil Corporation, of producing, buying, transporting, refining and selling oil. Between these subsidiary companies debts existed. All the funds had been invested in properties or were actually required to carry on the business, so that the debtor companies had no money available to pay their debts. Under these circumstances, such transaction was had that the result was merely that the Gulf Oil Corporation became the owner of the debts previously due from one of its companies to another. It was no richer than before, but its property now was

represented by stock in and debts due from its former subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books. This Court said:

> "It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the facts that they were related as parts of one enterprise, all owned by the petitioner, that the debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as 'dividends declared and paid in the ordinary course by a corporation.' "
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> *Gulf Oil Corporation vs. Llewellyn*, 248 U. S. 71, 72.

May we, as illustrative of our thought, cite a somewhat analogous case: In earlier days it was not uncommon for monied men in the East to select some enterprising person to whom they entrusted their money, to go into the then new West and acquire property, sometimes mining claims by prospecting, sometimes by purchase, sometimes ranches, or other property, or to conduct business, the person so sent giving to each person who contributed money, a memorandum showing the amount of money contributed by each and by all, and stating that the money was to be invested in the acquisition of property and the conduct of business in the West, the title to be held by the person to whom the money was entrusted, and the properties and business to be managed by this person. If the enterprise was successful and the selected person was honest, from time to time he made proportionate remittances to the associates, in money or in property. These remittances

thus were segregated from the enterprises in the shape of properties, or industries, or business carried on by the Western representative. The interest of each associate remained the same in the enterprise, but what he thus received became his to deal with as he saw fit. Let us suppose that a time came when this Western representative desired to lay down the burden, and that he selected some person to take his place, and that this selection was assented to by his associates. The substitution of the one trustee for the other in this case would be made by conveyance from the first trustee to the second trustee. Such conveyance would not at all affect the interest, either as a whole or proportionately, of the *cestui que trusts*, the associates in the East, yet, on the reasoning of the *Osgood* case, there would be a purchase and a sale, because there would be a conveyance from one person to another person of the legal title to the properties and the enterprises, and, under the reasoning of petitioner in the third sub-division of its brief, if the property had increased in value, there would have been an income derived by the transfer from the one trustee to the other trustee. We concede that the relations of the trustee and the *cestui que trusts* in this form of enterprise are not identical with the relations of a stockholder and a corporation, but they seem to us to be sufficiently analogous to point the argument that the mere transfer from one corporation to the other corporation in the case at bar did not suffice to make a purchase and a sale, giving rise to realized income.

In the next place, the underlying thought of the Supreme Court in the *Osgood* case seems to be the same as that in *Tax Commissioners vs. Putnam*, 227 Massachusetts, 522, the reasoning of which was specifically repudiated by this Court in the *Macomber* case. Counsel

for the plaintiff in error overlooked what this Court said of the reasoning of the Supreme Court of Massachusetts.

As to the second Massachusetts case referred to, *Stone vs. Tax Commissioners*, the remarks already made in relation to the *Osgood* case apply, but in addition to that, it is clear that the two companies were not identical. The facts were that the complainants owned stock in the National Carbon Company, a New Jersey corporation. They exchanged this stock for stock in the National Carbon Company, Inc., a New York corporation. This seems to have been a corporation identical with the New Jersey corporation, having the same assets and liabilities and the same stockholders. Even the Massachusetts Court does not hold that any income arose out of this exchange, and this exchange is like the exchange in the case at bar, with the exception that in the case at bar the new corporation was incorporated under the laws of the same State as the old, had the same objects and the same management. Then the complainants exchanged their stock in the National Carbon Company, Inc., for stock in another New York company, called the Union Carbide & Carbon Corporation, but the latter company acquired not only the property of the National Carbon Company, Inc., but that of three other corporations engaged in manufacturing not only the same product as the National Carbon Company, Inc., but other similar products, and issued its stock in exchange not only for the stock of the National Carbon Company, Inc., but for the stock of the other three companies, so that the stock of the Union Carbide & Carbon Company represented an interest in the assets and liabilities of four companies instead of one. It was on this exchange that the Supreme Court of Massachusetts held that a gain

was made, and we think rightly, because, unlike the case at bar, the new corporation represented an altogether different enterprise, different property, different assets, different stockholders from the old.

The next case we shall refer to was decided by the District Court of the United States for the Western District of Pennsylvania at the May Term, 1919. This case was a sequel to the above cited case of *Gulf Oil Corporation vs. Llewellyn*, 248 U. S. 71. To refinance the Gulf Oil Corporation it was decided early in 1913 to issue a 100 per cent. dividend on the then outstanding shares *declared to be payable in cash, but payment to be accepted in stock*, such payment being made possible by a concurrent increase in capital stock, which increase was in part effected by the capitalization of surplus acquired by its subsidiaries prior to 1913 and taken over from them in 1913, and to dispose of an amount of such increase equal to the original outstanding stock, for cash, at par, the principal stockholders undertaking to accept the dividend in stock, and to purchase their *pro rata* share of the new stock; and, further, the majority stockholders undertook to purchase for cash, at par, so much of the 100% new issue as might be declined by minority stockholders. The plan was put through, the holders of all but 1,740 shares accepting stock in payment of the dividend, and subscribing for their *pro rata* share of the new stock at par. Thus did the defendant.

> "Suit was for recovery of an income tax of $71,301 from the defendant, on the ground that the dividend, though paid in stock, was actually a cash dividend."

The resemblance to the case at bar will be seen. The dividend was called a cash dividend and was declared to be payable in cash, but payment to be accepted in stock,

as on the supposition in the case at bar that it was an actual sale to Eastman, Dillon & Company part of the payment was to be in stock, as to which there was no option whether it should be stock or cash. The Court says:

> "It is clear that if the resolution declaring the dividend in question, had provided for the payment of the dividend in stock, the dividend would not have been taxable. It is also clear that the defendant received payment of the dividend in shares of stock, *and that he did this pursuant to an agreement made prior to the declaration of the dividend, which agreement was communicated to the corporation before that declaration was made.*"

> "After the transaction, the defendant had two shares to represent the interest in the same property, which prior thereto was represented by one. After the transaction, there were twice as many shares of the corporation in the hands of stockholders as there were before. The corporate assets had not been diminished by the transaction. Therefore, for two shares which defendant possessed at the close, there was for him the same value as for one share represented at the beginning. It was fair and reasonable that the large stockholders should have regard to the interests of the small investors, who perhaps were more in need of pecuniary returns from their holdings, in that while giving them an equality of advantage they provided the means whereby such pecuniary returns would be made to them, not by the corporation itself but by T. Mellon & Sons through the medium of the corporation. * * * In every view of the transaction, we find that its substance is clear. In cases like the present, substance is controlling, and not form. The Court looks through all forms of corporate transactions, and has regard to the substance."

And the Court quotes from the already cited case of *Eisner vs. Macomber*, the following:

> "The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit, on the contrary, every dollar of his original investment, together with whatever accretion and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."
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> *United States vs. Mellon*, 279 Fed. 910, 914-5.

This decision was affirmed by the Circuit Court of Appeals.

United States vs. Mellon, 281 Fed. 645.

We conclude, therefore, that as to the stock in the new company there was no gain or profit derived from the transaction; that the respondent's interest continued to be exactly the same in the same property after the transaction as before; that as to the stock there was a mere reorganization of The National Acme Manufacturing Company into The National Acme Company from which no gain or profit was "*derived*" by the respondent, and hence there was no taxable income obtained.

Respectfully submitted,

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